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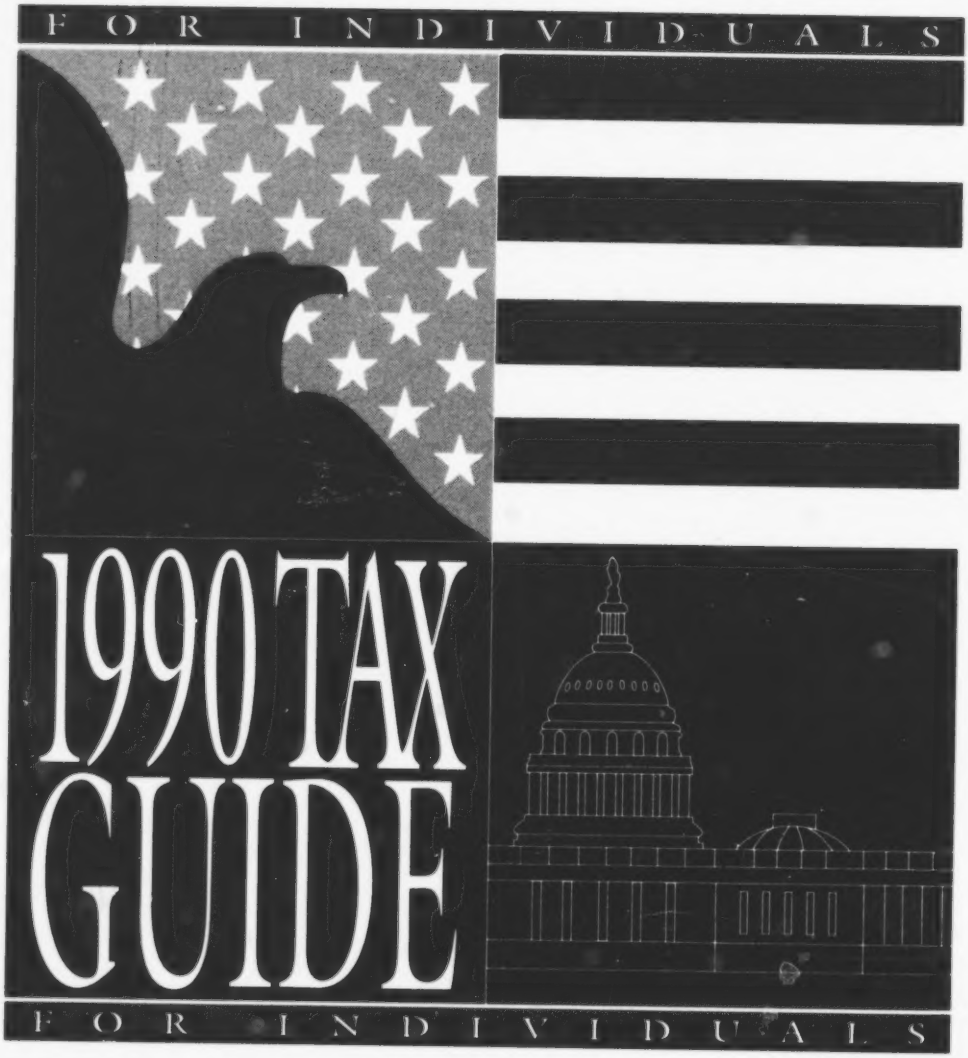
Department
of the
Treasury
**Internal
Revenue
Service**

Your Federal Income Tax

For Individuals

**Publication 17
For use in preparing
1990 Returns**



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Contents

Introduction.....1

Important Changes for 1990.....1

Important Reminders.....2

Part I The Income Tax Return

1 Filing Your Return.....4

2 Filing Status.....15

3 Personal Exemptions and Dependents.....18

4 Decedents.....25

5 Tax Withholding and Estimated Tax.....27

Part II Income

6 Wages, Salaries, and Other Earnings.....39

7 Income from Tips.....47

8 Interest Income.....48

9 Dividends and Other Corporate Distributions.....57

10 Rental Income and Expenses.....61

11 Retirement Plans, Pensions, and Annuities.....69

12 Social Security and Equivalent Railroad Retirement Benefits.....74

13 Other Income.....77

14 Tax Shelters.....83

Part III Gains and Losses

15 Basis of Property.....85

16 Sale of Property.....88

17 Selling Your Home.....93

18 Reporting Gains and Losses.....98

Part IV Adjustments to Income

19 Individual Retirement Arrangements (IRAs).....101

20 Alimony.....108

Part V Standard Deduction and Itemized Deductions

21 Standard Deduction.....112

22 Medical and Dental Expenses.....115

23 Taxes.....118

24 Interest Expense.....121

25 Contributions.....125

26 Nonbusiness Casualty and Theft Losses.....128

27 Moving Expenses.....133

28 Car Expenses and Other Employee Business Expenses.....138

29 Employees' Educational Expenses.....152

30 Miscellaneous Deductions.....155

Part VI Figuring Your Taxes and Credits

31 How to Figure Your Tax.....160

32 Tax on Investment Income of Certain Minor Children.....163

33 Child and Dependent Care Credit.....169

34 Credit for the Elderly or the Disabled.....176

35 Other Credits.....181

Part VII Sample Returns

36 Form 1040EZ.....184

37 Form 1040A.....186

38 Form 1040.....192

The Examination and Appeals Process.....208

Tax Table.....209

Tax Rate Schedules.....215

Earned Income Credit Table.....216

Tele-Tax Information.....218

IRS Toll-Free Telephone Numbers.....220

Index.....221

List of Tax Publications.....226

Order Blank.....227

The Federal Budget ***(Inside back cover)***

Where to File ***(Outside back cover)***

The explanations and examples in this publication reflect the interpretation by the Internal Revenue Service of:

- Tax laws enacted by Congress,
- Treasury regulations, and
- Court decisions.

However, the information given does not cover every situation and is not intended to replace the law or change its meaning.

This publication covers some subjects on which a court may have made a decision more favorable to taxpayers than the interpretation of the Service. Until these differing interpretations are resolved by higher court decisions or in some other way, this publication will continue to present the interpretation of the Service.

All taxpayers have appeal rights within the Service and may appeal to the courts when they do not agree with the interpretation of the Service. Appeal procedures are described in *The Examination and Appeals Process*, in the back of this publication.

All material in this publication may be reprinted freely. A citation to *Your Federal Income Tax (1990)* would be appropriate.

Introduction

This publication can help you prepare your own tax return by taking you step by step through each part of the return. It explains the tax law in plain language and will help you better understand your taxes so that you pay only as much tax as you owe and no more.

The publication begins with the rules for filing a tax return. It explains who must file a return, which tax form to use, when the return is due, and other general information. It will help you decide which filing status you qualify for, whether you can claim any dependents, and whether the income you are receiving is taxable. The publication goes on to explain the standard deduction, the kinds of expenses you may be able to deduct (like medical expenses, donations to charities, etc.), and the various kinds of credits you may be able to take to reduce your tax.

Throughout the publication are examples showing how the tax law applies in typical situations. Sample forms and schedules show you how to fill out your return.

The index in the back of the publication will help you find the information you need as quickly as possible. Also in the back are lists of free tax help available to you, including other publications, tape recorded information, materials that are available in Spanish, and where to call to get further assistance.

If you operate your own business or have other self-employment income such as babysitting or selling crafts, see these other publications for more information:

- Publication 334, *Tax Guide for Small Business*,
- Publication 535, *Business Expenses*, and
- Publication 533, *Self-Employment Tax*.

You can get free IRS publications by calling 1–800–TAX–FORM (1–800–829–3676) or by using the order form in the back of this publication. Many public libraries also have reference sets of these publications that you can use.

We welcome your suggestions for future editions of this publication. Please send your ideas to:

Internal Revenue Service
Technical Publications Branch (T:FP:P)
1111 Constitution Ave., NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your area code and daytime phone number along with your return address.

Important Changes for 1990

This section summarizes important tax changes that took effect since this publication was last revised. These changes are discussed in more detail throughout this publication.

These changes are also discussed in Publication 553, *Highlights of 1990 Tax Changes*.

Pending legislation. As this publication was being prepared for print, Congress was considering changes to the tax law that could affect items on your 1990 income tax return. These proposed changes are explained in the chapters of this publication.

In addition, proposed changes to the tax law could affect your 1991 tax. If these proposals are enacted, you may need to adjust your withholding or estimated tax payments to avoid owing a penalty for underpayment of estimated tax. See Chapter 5 for highlights of the items that may be changed.

Expanded Form 1040A. If you had to file Form 1040 last year, you may be able to file Form 1040A this year instead. The expanded Form 1040A now lets you report pension and annuity payments, taxable social security and railroad retirement benefits, and payments from your IRA. It also lets you claim the credit for the elderly or the disabled, take credit for your estimated tax payments, and make an election to apply all or part of your 1990 refund to your 1991 estimated tax. See Chapter 1.

Filing requirements. Generally, the amount of income you can have before you are required to file a return has been increased. See Chapter 1.

Tax indexing. The Tax Table and Tax Rate Schedules have been adjusted so that inflation will not increase your tax.

Higher exemption amount. For 1990, you are allowed a $2,050 deduction for each exemption to which you are entitled.

Standard deduction. For most people, the standard deduction has increased. Because of this increase, it may benefit you to take the standard deduction for 1990 even though you itemized deductions in past years. See Chapter 21.

Earned income credit. If your earned income and your adjusted gross income are both less than $20,264 and you have a child who lived with you for more than half the year, you may be entitled to a refundable credit of up to $953. See Chapter 35.

Personal interest. For 1990, the portion of personal interest expense you can deduct is smaller. Personal interest includes interest on car loans, credit cards, and personal loans. You can deduct only 10% of the personal interest you paid in 1990. See Chapter 24.

Extensions of expiring tax items. The following items, scheduled to expire at the end of 1989 or earlier, were extended through September 30, 1990.

- Exclusion for employer-provided educational assistance (see Chapter 6)
- Exclusion for employer-provided group legal services (see Chapter 6)
- Deduction for 25% of the health insurance costs of self-employed individuals (see Chapter 22)
- Authority for states and local governments to issue mortgage credit certificates allowing a mortgage interest credit to homebuyers (see Chapter 35)

Education Savings Bond Program. Beginning in 1990, all or part of the interest from certain U.S. savings bonds can be excluded from income if you pay qualified higher education expenses during the year you redeem the bonds. See Chapter 8.

Standard mileage rate. For 1990, the standard mileage rate for the business use of a car is 26 cents a mile for all business miles. You are not subject to the 15,000-mile annual limit that applied in prior years. See Chapter 26.

Cellular telephones. Beginning in 1990, you must use special rules to figure your deduction for a cellular telephone used in your business. See Chapter 30.

Deduction for self-employment tax. Beginning in 1990, you can deduct one-half of your self-employment tax for the year in figuring adjusted gross income. See Chapter 23.

Self-employment tax. For 1990, the self-employment tax is 15.3% of the ***smaller*** of (1) 92.35% of your net earnings from self-employment or (2) $51,300 minus your wages subject to social security or railroad retirement tax.

Penalties. There are new rules for certain "accuracy" penalties, including the penalties for negligence and for substantial understatement of income tax. The penalties have increased for failing to provide a social security number and for failing to file a return when the failure is due to fraud. See Chapter 1.

Short method for figuring the estimated tax penalty. Beginning in 1990, if you owe a penalty for underpayment of estimated tax, you may be able to figure it using fewer computations. See Chapter 5.

Change of address. If you change your address, you should use the new Form 8822, *Change of Address*, to notify the Internal Revenue Service.

Citizens detained in Iraq and Kuwait. The Internal Revenue Service will suspend tax examination and collection actions for U.S. citizens detained in Iraq and Kuwait. These citizens will receive this administrative relief under the IRS policy for taxpayers in hostage situations.

To implement the relief policy, IRS needs to be contacted by family members of detained citizens. If you are a family member of a detainee, you should call a special toll-free number, 1–800–829–4351, as soon as possible so that the IRS can take steps to suspend actions already scheduled or underway and prevent new actions from being scheduled.

When informing the IRS of a detained citizen's identity, you should be prepared to provide the name and social security number of the detainee, along with any information you may be aware of concerning the detainee's ongoing actions with the IRS.

Examination and collection actions that can be precluded or suspended include audits of tax returns and mailings of notices or other actions involving the collection of overdue taxes.

Important Reminders

Listed below are important reminders and other items that may help you file your 1990 tax return. Many of these items are explained in more detail later in this publication.

Form W–2. You should receive your 1990 Form W–2, *Wage and Tax Statement,* by January 31, 1991. If you have not received your Form W–2 by January 31, ask your employer for it. If you do not receive it by February 15, call the toll-free number for your area listed near the end of this publication. See Chapter 5.

File one federal tax return. File only one federal tax return regardless of the number of jobs you had, Forms W–2 you received, or states you lived in during the year.

Tax return preparers. Choose your preparer carefully. If you pay someone to prepare your return, the preparer is required, under the law, to sign the return and fill in the other blanks in the Paid Preparer's area of your return. Remember, however, that you are still responsible for the accuracy of every item entered on your return. If there is any underpayment, you are responsible for paying it, plus any interest and penalty that may be due. Therefore, you should be careful to choose someone who understands tax matters and will prepare a complete and accurate tax return.

Fast refund. If you expect a tax refund for 1990, instead of mailing your return to the Internal Revenue Service, you can have it filed electronically. When you file electronically, you will get your refund in about 3 weeks, or in about 2 weeks if you have it deposited directly into your checking or savings account. See Chapter 1.

Substitute tax forms. You cannot use your own version of a tax form unless it meets the requirements explained in **Publication 1167** for acceptable privately designed and printed substitute tax forms. You can get Publication 1167 by writing to the Forms Distribution Center for your state. See the addresses on the Order Blank page near the back of this publication.

Check the name and social security number on your tax form. If both the name and social security number on your tax form do not agree with your social security card, your refund may be delayed or you may not receive credit for your social security earnings. If your Form W–2, Form 1099, or other tax document shows an incorrect social security number or name, notify your employer or the form-issuing agent. If the name or number on your social security card is incorrect, call the Social Security Administration toll free at 1–800–234–5772.

Rounding off. It is easier to complete your tax return if you round off all money amounts. This means that you drop amounts under 50 cents. For example, $25.32 becomes $25.00. You increase amounts that are 50 cents or more to the next dollar so that, for example, $25.50 becomes $26.00.

If you do round off, do so for all amounts on your return. However, if you have to add two or more amounts to figure the total to enter on a line, include cents when adding the amounts and round off only the total.

Example. You received two W–2 forms, one showing wages of $5,000.55 and one showing wages of $18,500.73. On your return you would enter $23,501 ($5,000.55 + $18,500.73 = $23,501.28) instead of $23,502 ($5,001 + $18,501).

Filing reminders. Before you file your return, be sure you do all of the following.

- Put all income, deductions, credits, and tax items on the correct lines.
- Use the correct chart or worksheet if you take the standard deduction.
- Use the correct column in the Tax Table or the appropriate Tax Rate Schedule.
- Fill out Schedule SE (Form 1040) if you earned less than $51,300 subject to social security or RRTA withholding and had self-employment income of $400 or more (or Form W–2 wages of $100 or more from an electing church or church-controlled organization).
- Check your math carefully.
- Sign and date your return. On a joint return both husband and wife must sign.
- If you received a tax return package with an address label, transfer the label to your return and make any necessary corrections to it. Use the label from your federal tax return package and not the one that came with your state tax return. Using the label helps us identify your account, saves processing time, and speeds refunds.
- Attach all Forms W–2 to your return.
- Attach all forms and schedules in attachment sequence number order. The attachment sequence number is in the upper right corner of the schedule or form. Attach all other statements or attachments last, even if they relate to another form or schedule. Do not attach these other statements to the related form or schedule.
- Attach your check or money order for the full amount you owe. Write your social security number, address, daytime telephone number, form number, and tax year on your check or money order.
- If an addressed envelope came with your return, use it (unless you moved during the year) and be sure to use enough postage.

Note. If you pay the first installment of your 1991 estimated tax at the same time you file your 1990 return, ***do not*** send it with your return. Use a separate check or money order and mail it in a separate envelope to the address for your area given in the instructions for Form 1040–ES, *Estimated Tax for Individuals.*

Presidential election campaign fund. You can have $1 of your tax ($2 if married filing jointly) go to a general fund established by Congress to help pay for Presidential election costs. See Chapter 1.

Gift to reduce the public debt. You can make a voluntary gift to reduce the public debt. To do so, enclose a separate check, payable to *Bureau of the Public Debt,* with your 1990 income tax return. See Chapter 1.

Where to file. If an addressed envelope came with your 1990 return, please use it. If you do not have one, or if you moved during the year, mail your return to the address listed for your area under *Where to File* on the back cover of this publication.

File on time — even if you cannot pay. If you do not have the money to pay the amount you owe on your return, you should file your return on time and pay what you can. The IRS will bill you for the balance due, plus interest if the balance is not paid by the due date. You may also have to pay a failure-to-pay penalty.

If you do not file your return by the due date, you will have to pay interest on the amount you owe, and you may have to pay a failure-to-pay penalty plus interest on the penalty. You may also have to pay a failure-to-file penalty, plus interest. See Chapter 1.

Records and receipts. Do not send in records, receipts, or canceled checks with your tax return. Keep your records available so that you can produce them if the amounts you claim on your return are ever questioned.

You should keep records that support items of income or deductions on a return at least until the period of limitations on the return runs out.

You should keep records that relate to the basis of property as long as they are important in figuring the basis of the property. See Chapter 1.

Copy of return. Keep a copy of your tax return. It may be helpful in amending a filed return or preparing future returns. You can ask the IRS for a copy of a prior year tax return or a transcript of tax account information. See Chapter 1.

Address change. If you move, be sure to notify the IRS using Form 8822, *Change of Address.* Mail it to the Service Center where you filed your last return. Addresses for the Service Centers are on the back of the form. If you are changing both your home and business addresses, complete two separate forms.

If you move after you file your return and you are expecting a refund, also notify the post office serving your old address. This will help to forward your check to your new address.

Refund information. Usually, you will receive your refund about 6 weeks after filing your return. If it has been at least 8 weeks since you mailed your 1990 tax return, you can use Tele-Tax to find out the status of your income tax refund by telephone. For details on how to use this service, see *What is Tele-Tax?* near the back of this publication.

Refund checks. Be sure to cash your refund check soon after you receive it. Checks not cashed within 12 months of the date of the check will be canceled.

Refund more or less than expected. If you received a check for a refund you are not entitled to, or for an overpayment that should have been credited to estimated tax, do not cash the check. Call the IRS toll-free number for your area.

If you received a check for more than the refund you claimed, do not cash the check until you receive a notice explaining the difference.

If your refund check is for less than you claimed, it should be accompanied by an explanation. Cashing the check does not stop

you from claiming an additional amount of refund.

If you have any questions about the amount of your refund, call the IRS toll-free number for your area.

Amended return. If you find changes in your income, deductions, or credits after you mail your return, file Form 1040X, *Amended U.S. Individual Income Tax Return*, to change the return you already filed. See Chapter 1.

Death of taxpayer. If a taxpayer died before filing a required return for 1990, the taxpayer's personal representative (and spouse, in the case of a joint return) must file and sign a return for that person. A personal representative can be an executor, administrator, or anyone who is in charge of the taxpayer's property. See Chapter 4.

Privacy Act and paperwork reduction information. The Privacy Act of 1974 and the Paperwork Reduction Act of 1980 say that when we ask you for information we must tell you what our legal right is to ask for the information, why we are asking for it and how it will be used, what could happen if we do not receive it, and whether your response is voluntary, required to obtain a benefit, or mandatory under the law. A complete statement on this subject can be found in the instructions for Form 1040, Form 1040A, and Form 1040EZ.

Do you want more or less tax withheld in 1991? If your 1990 refund is large and you want to have less tax withheld from your pay, you should get Form W–4, *Employee's Withholding Allowance Certificate*, from your employer. Complete Form W–4 claiming any additional allowance you are entitled to, and return the form to your employer. If you owe tax this year, you may need to give your employer a completed Form W–4 claiming fewer allowances or asking for an additional amount to be withheld from each paycheck. See Chapter 5.

Estimated tax. Several changes to the tax laws for 1991 may affect whether you must make estimated tax payments and the amount of your payments. Generally, you must make estimated tax payments if you expect to owe at least $500 and you expect your withholding and credits to be less than the smaller of (1) 90% of the tax shown on your 1991 return or (2) 100% of the tax shown on your 1990 return. See Chapter 5.

Employment taxes for household employees. If you pay someone, such as a babysitter, to work in your home, you may have to pay employment taxes. See Chapter 33.

Free tax help. The IRS provides free tax information and services. Publication 910, *Guide to Free Tax Services*, describes the publications and services available to taxpayers.

Videotaped instructions. Videotaped instructions for completing your tax return are available in either English or Spanish at participating libraries.

Information publications. Over 100 publications with information about taxes are available free from the IRS. See the *Tax Publications* list near the end of this publication.

Tele-Tax. This telephone service provides recorded tax information on about 140 topics. Beginning March 1, Tele-Tax can also tell you the status of your refund. See *What Is Tele-Tax?* near the end of this publication.

Walk-in service. Assistors are available in most IRS offices throughout the country to help you prepare your own return. In this way, you will be given the opportunity to learn how to research and prepare your own tax return. An assistor will "walk through" a return with you and a number of other taxpayers in a group setting.

If you want help with your tax return, you should bring in your tax package, Forms W–2 and 1099, and any other information (such as a copy of last year's return) that will help the assistor to help you.

At most IRS offices you can also get tax forms, publications, and help with questions about IRS notices or bills.

Telephone help. IRS representatives are available to answer your tax questions by telephone. If, after reading the tax form instructions and IRS tax publications, you are not sure how to fill out your return, or you have a question about an IRS notice, please call the IRS toll-free number for your area. These numbers are listed near the back of this publication.

Telephone service for hearing-impaired persons. This service is available to hearing-impaired taxpayers who have access to TDD equipment. Call 1–800–829–4059.

Information for the blind. Braille materials are available at regional libraries for the blind and handicapped in conjunction with the Library of Congress. These materials include this publication, Publication 334, *Tax Guide for Small Business*, and Forms 1040, 1040A, and 1040EZ and their instructions.

Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE). Free help is available in most communities to older, disabled, and non-English-speaking people in preparing Form 1040EZ, Form 1040A, and the basic Form 1040. Call the toll-free telephone number for your area for the location of the volunteer assistance site near you.

Written tax questions. You can send your written tax questions to your IRS District Director. If you do not have the address, you can get it by calling the toll-free number for your area.

Corresponding with IRS. Be sure to include your social security number in any correspondence with IRS.

Unresolved tax problems. The Problem Resolution Program is for taxpayers who have been unable to resolve their problems with the IRS. If you have a tax problem you cannot clear up through normal channels, write to your local IRS District Director or call your local IRS office and ask for Problem Resolution assistance. Hearing-impaired taxpayers who have access to TDD equipment may call 1–800–829–4059 to ask for help from Problem Resolution.

This office cannot change the tax law or technical decisions. But it can help you clear up problems that resulted from previous contacts.

Part I
The Income Tax Return

The five chapters in this part provide basic information on the tax system. They take you through the first steps of filing out a tax return—such as deciding what your filing status is, how many exemptions you can take, and which form to file. They also discuss recordkeeping requirements, and the two methods used to pay tax during the year: withholding and estimated tax.

1. Filing Your Return

Important Changes for 1990

Filing requirements. Generally, the amount of income you can receive before you are required to file a return has been increased.

Change of address. If you change your address for any reason, you should use the new Form 8822, *Change of Address,* to notify the Internal Revenue Service. See *Change of Address,* later.

Form 1040A changes. Form 1040A has been expanded to include IRA payments, pensions and annuities, taxable social security and railroad retirement benefits, and the credit for the elderly or the disabled. New lines have been added to include advance earned income credit payments received in 1990, estimated tax payments made in 1990, and the election to apply all or part of your 1990 refund to your 1991 estimated tax. See *Form 1040A,* later.

Penalties. Congress made changes to various penalties related to accuracy, such as the penalties for negligence and substantial understatement of income tax. In addition, the penalties for failure to supply a social security number and for failure to file a return when fraud is involved have increased. See *Penalties,* later.

This chapter contains general information for filing a return. It includes the following:

Who Must File and Who Should File
Which Form to Use
How to File and When to File
Refunds, Amount You Owe, and Penalties
Amended Returns and Claims for Refund
Where to File
Recordkeeping

Who Must File

If you are a citizen or resident of the United States or a resident of Puerto Rico, you must file a federal income tax return if you meet the filing requirements for any of the following categories:

- Individuals—In General
- Dependents
- Self-Employed Persons
- Surviving Spouses, Executors, Administrators, or Legal Representatives
- U.S. Citizens Living Abroad
- Residents of Puerto Rico
- Aliens

The filing requirements for these categories apply even if you do not owe tax.

Note. File only ***one*** federal tax return regardless of the number of jobs you had, Form(s) W–2 received, or how many states you lived in during the year.

Individuals—In General

If you are a U.S. citizen or resident, your filing requirement depends on your gross income, your filing status, and your age.

Gross income includes all income you receive in the form of money, goods, property, and services that is not exempt from tax. Common types of income are discussed in the chapters in Part II of this publication.

Community property. If you are married and live with your spouse in a community property state, half of any income described by state law as community income may be considered to be yours. See Publication 555, *Federal Tax Information on Community Property.*

Self-employed individuals. If you are self-employed, your gross income includes the amount on line 7 of Schedule C (Form 1040), *Profit or Loss From Business.* See *Self-Employed Persons,* later, for more information about your filing requirements.

Filing status is determined as of the last day of your tax year, which is December 31 for most taxpayers. See Chapter 2 for an explanation of each filing status.

Age. If you are 65 or older at the end of the year, the requirement to file a return may be different for you. You can generally have a higher amount of gross income than other taxpayers before you are required to file. You are considered 65 on the day before your 65th birthday. For example, if your 65th birthday was on January 1, 1991, you are considered 65 for 1990. See *Filing requirements table,* next.

Filing requirements table for most taxpayers. Generally, if you are a U.S. citizen or resident, you must file a tax return if your gross income for the year is at least as much as the amount shown for your filing status and age in the following table. Dependents should see *Dependents,* later.

Filing Status*	1990 Gross Income
Single	
Under 65	$ 5,300
65 or older	6,100
Married Filing Joint Return	
Both spouses under 65	$ 9,550
One spouse 65 or older	10,200
Both spouses 65 or older	10,850
Not living with spouse at end of year (or on date spouse died)	2,050
Married Filing Separate Return	
All—regardless of age	$ 2,050
Head of Household	
Under 65	$ 6,800
65 or older	7,800
Qualifying Widow(er)	
Under 65	$ 7,500
65 or older	8,150

*Being blind does not change your filing requirement.

Exceptions. Even if your income is **less** than the amount shown as your filing requirement, you ***must*** file a return if you owe any other taxes, such as:

- Self-employment tax on net earnings of at least $400 from self-employment.
- Social security tax on tips you did not report to your employer. See Chapter 7.
- Uncollected social security tax or railroad retirement tax on tips you reported to your employer. See Chapter 7.
- Alternative minimum tax. See Chapter 31.
- Tax on an IRA or a qualified retirement plan. See Chapter 19.
- Tax you may have to repay on an investment credit or a low-income housing credit you claimed in a previous year. See the instructions for Form 3800, *General Business Credit.*

If you receive any advance earned income credit payments from your employer, you must file a return. See Chapter 35.

Wages exempt from employer social security taxes. Even if you are not otherwise required to file, you must file a return if you had wages of $100 or more from a church or qualified church-controlled organization that is exempt from employer social security taxes. See Publication 533, *Self-Employment Tax.*

Income from U.S. Possessions. If you had income from Guam, the Northern Mariana Islands, American Samoa, the Virgin Islands, or Puerto Rico, special rules may apply in determining whether you must file a U.S. federal income tax return. In addition, you may have to file a return with the individual island government. See Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions,* for more information.

Dependents

If you are a dependent (one who meets the *dependency tests* in Chapter 3), the requirement to file a return depends on:

- The amount of your earned or unearned income,
- The amount of your gross (total) income,
- Whether you are single or married,
- Whether you are 65 or older, and
- Whether you are blind.

See Charts 1, 2, and 3, in this chapter to determine whether a dependent must file a return.

Earned income is salaries, wages, tips, professional fees, and other amounts received as pay for work actually done.

Filing Requirements Charts for Dependents

The three charts that follow can be used to determine whether a dependent must file a return.

Chart 1 is for all dependents who are under 65 and are not blind.
Chart 2 is for single dependents who are 65 or older or blind.
Chart 3 is for married dependents who are 65 or older or blind.

Use only the chart that fits the dependent's circumstances.

Do not use a chart for the dependents listed below. These persons either must file a return, or should get a refund.

A married dependent with at least $5 of income whose spouse itemizes deductions on a seperate return
A dependent with at least $400 of net self-employment income
A dependent who owes certain other taxes
A dependent who had income tax withheld

How to use the charts. Answer the questions in the block labeled "Start Here". Follow the arrow marked "Yes" or the arrow marked "No," depending on your answer to the question in the block. Continue answering questions and following arrows until you reach a block that does not have a question in it. That block will tell you whether or not the dependent must file a return.

Chart 1. Dependents Under 65 and Not Blind

Start Here

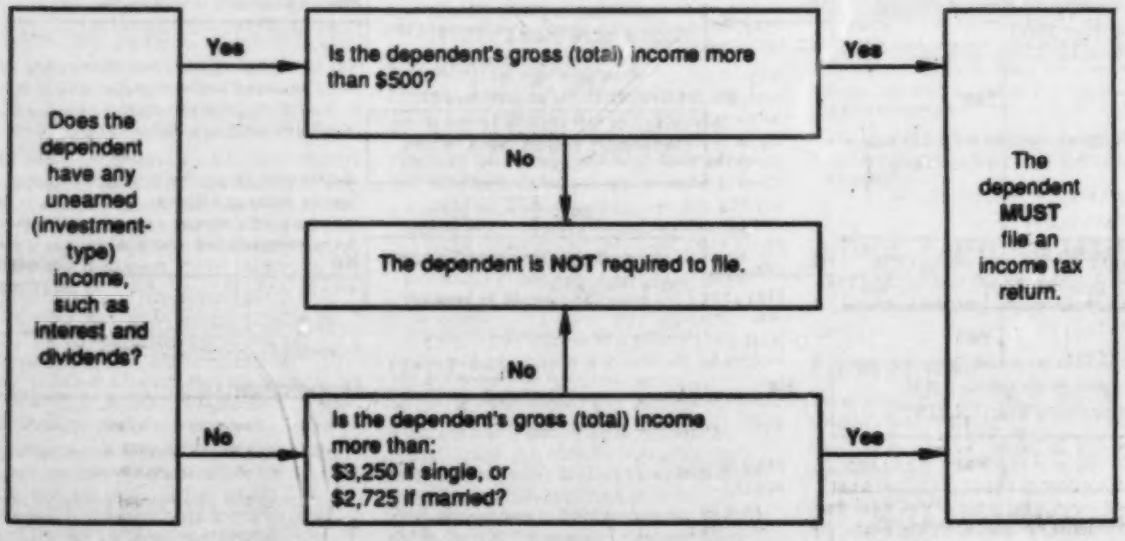
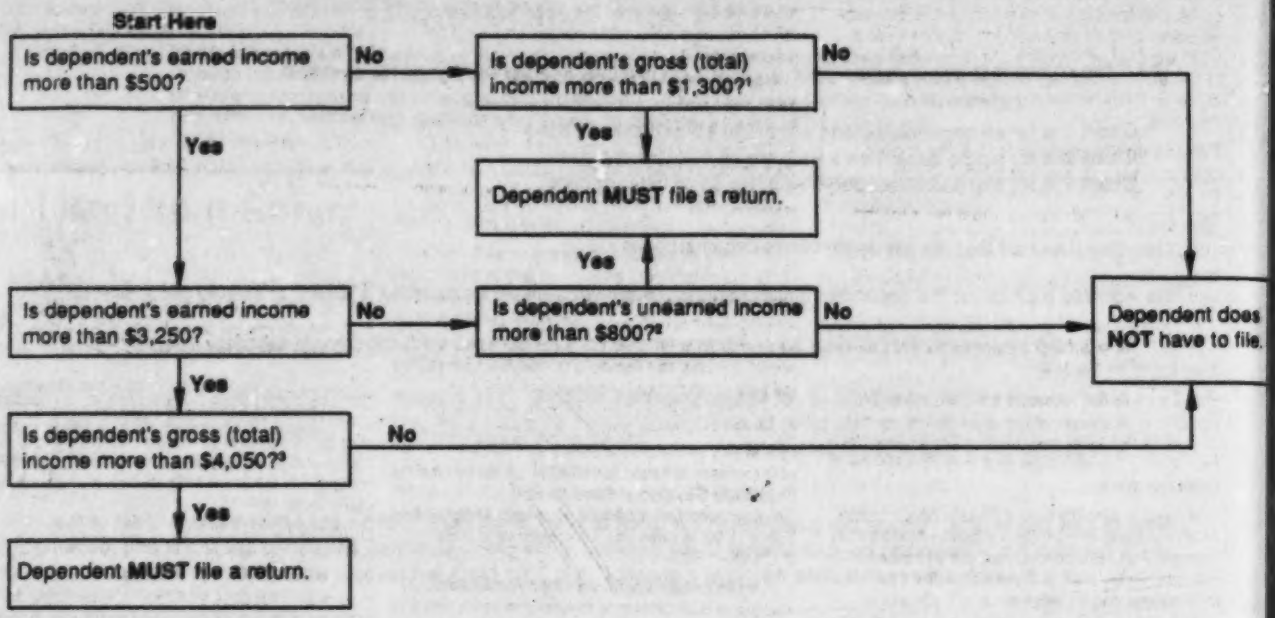
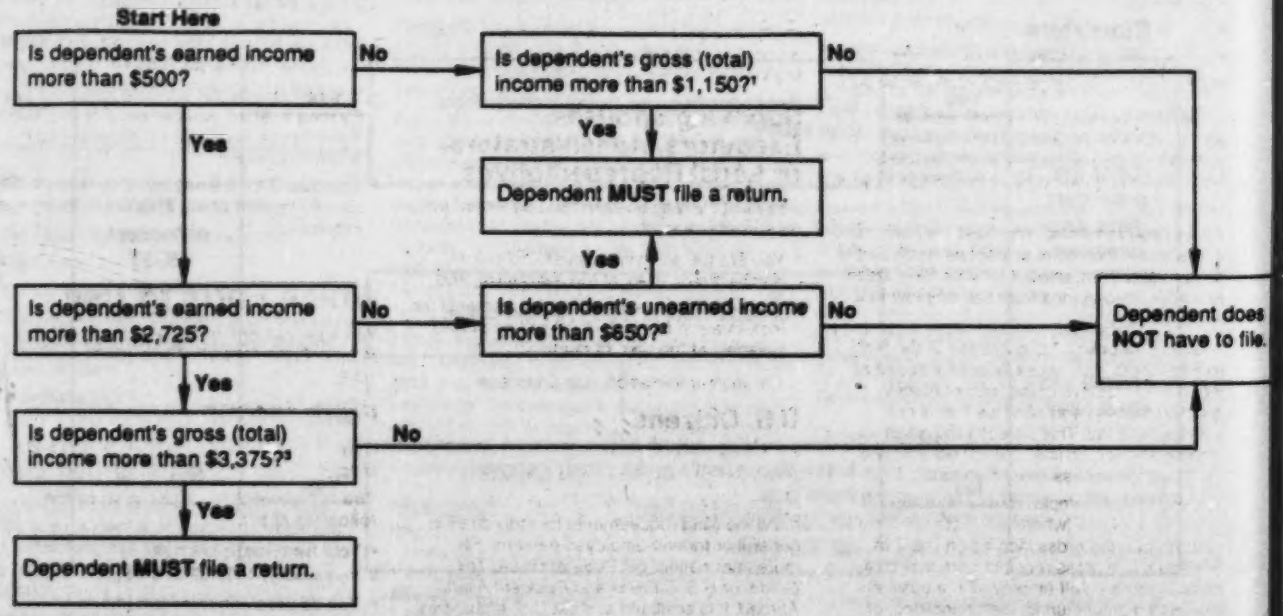

Does the dependent have any unearned (investment-type) income, such as interest and dividends?
Yes
Is the dependent's gross (total) income more than $500?
Yes
The dependent MUST file an income tax return.
No
The dependent is NOT required to file.
No
No
Is the dependent's gross (total) income more than:
$3,250 if single, or
$2,725 if married?
Yes

Chart 2. Single Dependents 65 or Older or Blind



[1]Use $2,100 if the dependent is 65 or older *and* blind.
[2]Use $1,600 if the dependent is 65 or older *and* blind.
[3]Use $4,850 if the dependent is 65 or older *and* blind.

Chart 3. Married Dependents 65 or Older or Blind



[1]Use $1,800 if the dependent is 65 or older *and* blind.
[2]Use $1,300 if the dependent is 65 or older *and* blind.
[3]Use $4,025 if the dependent is 65 or older *and* blind.

Unearned income is income other than earned income. It includes investment-type income such as interest, dividends, and capital gains. Distributions of interest, dividends, capital gains, and other unearned income from a trust are also unearned income to a beneficiary of the trust. Unearned income also includes social security benefits, pensions, and annuities.

Responsibility of parent. If a dependent child with taxable income cannot file an income tax return, a parent, guardian, or other legally responsible person must file it for the child. If the child cannot sign the return, the filer must sign the child's name followed by the words "By (your signature), parent (or guardian) for minor child."

If a child's tax is not paid, the parent or guardian is liable for the income tax on salaries and wages of the child.

Child's income. Amounts a child earns by performing services are taxable to him or her, even if under local law the child's parents have the right to the earnings and may actually have received them.

Parent's election. If a child's only income is interest and dividends (including Alaska Permanent Fund dividends) and certain other conditions are met, a parent can elect to include the child's income on the parent's return. If this election is made, the child is not required to file a return. See *Parent's Election to Include Child's Income*, in Chapter 32. Also see Publication 929, *Tax Rules for Children and Dependents.*

Self-Employed Persons

You are self-employed if you:

- Carry on a trade or business as a sole proprietor.
- Are an independent contractor.
- Are an active member of a partnership.
- Are in business for yourself in any other way.

Self-employment can include work in addition to your regular full-time business activities. It also includes certain part-time work that you do at home or in addition to your regular job.

Filing requirements. You must file Form 1040 if your gross income is at least as much as the filing requirement amount for your filing status or if your net earnings from self-employment are $400 or more.

Gross income. For purposes of the filing requirements, your gross income includes all income you receive in the form of money, goods, property, and services that is not exempt from tax. This includes the gross income amount on line 7 of Schedule C (Form 1040), *Profit or Loss From Business.*

If you are self-employed in a business that provides services (where products are not a factor), then the gross income on line 7 of Schedule C is gross receipts from that business. If you are self-employed in a business involving manufacturing, merchandising, or mining, the gross income on line 7 of Schedule C is the total sales from that business less cost of goods sold, plus any income from investment and incidental or outside operations or sources.

Net earnings of $400 or more. You must file Form 1040 if you had net earnings of $400 or more from self-employment. Net earnings from self-employment generally are the net income (gross income minus deductible business expenses) from your business or profession. The $400 net earnings figure applies regardless of your age. For more information about net earnings, see Publication 533, *Self-Employment Tax.*

Net earnings of less than $400. If you have net earnings from self-employment of less than $400 (or even a loss), you may have to file Form 1040. You must file Form 1040 if your gross income is at least as much as the filing requirement amount shown for your filing status on the *Filing requirements table*, shown earlier. If you must file, you are required to show your net self-employment income (or loss) on your Form 1040.

Self-employment tax. You must pay self-employment tax on your net earnings from self-employment. This tax is comparable to the social security tax withheld from an employee's wages. An individual who earned less than $51,300 in 1990 as an employee and earned $400 or more from self-employment normally has to pay self-employment tax. The self-employment tax rate for 1990 is 15.30%. Use **Schedule SE,** *Social Security Self-Employment Tax,* to figure your tax. Attach it to Form 1040. A copy of this schedule is shown in Chapter 38.

Foreign organizations or governments. If you are a U.S. citizen who works in the United States for an international organization, a foreign government, or a wholly owned instrumentality of a foreign government, and that work is exempt from social security employee tax, you must pay self-employment tax on earnings from services performed in the United States.

Employees of churches. If you work for a church or a qualified church-controlled organization that elected exemption from social security taxes, you will have to pay self-employment tax if you are paid $100 or more in a year by the church organization. See Publication 533 for more information.

Surviving Spouses, Executors, Administrators, or Legal Representatives

You must file a final return for a decedent (a person who died) if:

- You are the surviving spouse, executor, administrator, or legal representative, and
- The decedent met the filing requirements for individuals in general, or for self-employed persons, at the date of death.

For more information, see Chapter 4.

U.S. Citizens Living Abroad

If you are a U.S. citizen living outside the United States, you must file a return if you meet the filing requirements for individuals in general or for self-employed persons. For more information, get Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.* It is available at most U.S. embassies and consulates, or you can order it. Use the order blank at the end of this publication.

Residents of Puerto Rico

If you are a resident of Puerto Rico for the entire year, you must file a U.S. income tax return if you meet the filing requirements for individuals in general or for self-employed persons. Gross income, for purposes of the filing requirements, does not include income from sources within Puerto Rico, except for amounts received as an employee of the United States or a United States agency. See Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions,* for further information.

Aliens

Your status as an alien—resident, nonresident, or dual-status—determines how you file your income tax return.

The rules used to determine if you are a resident or nonresident alien are discussed in Publication 519, *U.S. Tax Guide for Aliens.*

Resident aliens. If you are a resident alien for the entire year, you must file a tax return following the same rules that apply to U.S. citizens. Use the forms discussed in this publication.

Nonresident aliens. If you are a nonresident alien, the rules and tax forms that apply to you may be different from those that apply to U.S. citizens. See Publication 519 to find out if U.S. income tax laws apply to you and which forms you should file.

Dual-status taxpayers. If you were a resident alien for part of the tax year and a nonresident alien for the rest of the year, you are a dual-status taxpayer. Different rules apply for the part of the year you were a resident of the United States and the part of the year you were a nonresident. For information on dual-status taxpayers, see Publication 519.

Joint return. If you were married to a person who was a U.S. citizen or resident on the last day of the tax year, you may be able to file a joint return with your spouse. See Publication 519.

Who Should File

Even if you are not required to file, you should file a federal income tax return if:

- You had income tax withheld from your pay. By filing a return, you can get a refund even if you can be claimed as a dependent by another taxpayer.
- You qualify for the earned income credit. See *Earned Income Credit* in Chapter 35 for more information.

Which Form to Use

You must use one of three forms to file your return—Form 1040EZ, Form 1040A, or Form 1040.

Form 1040EZ

If you are single, you may be able to use the simpler Form 1040EZ.

You can use Form 1040EZ if all of the following apply:

- Your filing status is single.
- You are not 65 or older or blind.
- You do not claim any dependents.
- Your taxable income is less than $50,000 and is only from wages, salaries, tips, taxable scholarships and fellowships, and interest of $400 or less.
- You do not itemize deductions, claim any adjustments to income or tax credits, receive advance earned income credit payments, or owe any taxes other than the amount from the Tax Table.

If you do not meet all these requirements, you cannot use Form 1040EZ. You must use Form 1040A or Form 1040.

Form 1040A

If you do not qualify to use Form 1040EZ, you may be able to use Form 1040A.

You can use Form 1040A if:

- Your income is only from wages, salaries, tips, IRA distributions, annuities and pensions, social security and railroad retirement benefits, taxable scholarships and fellowships, interest, dividends (except for Alaska Permanent Fund dividends), and unemployment compensation.
- Your taxable income is less than $50,000.
- You do not itemize your deductions.
- Your only deduction is for certain contributions to an IRA.
- Your only credits are:
  a) The credit for child and dependent care expenses (see Chapter 33).
  b) The credit for the elderly or the disabled (see Chapter 34).
  c) The earned income credit (see Chapter 35).

If you do not meet all of the above requirements, you cannot use Form 1040A. For example, you may want to claim itemized deductions which you cannot claim on Form 1040A. Check the list under *You must use Form 1040* to see if you are required to use Form 1040.

Form 1040

You may have received Form 1040A or Form 1040EZ in the mail because of the return you filed last year. If your situation has changed this year, it may be to your advantage to file Form 1040 instead. You may pay less tax by filing Form 1040 because you can take itemized deductions, adjustments to income, and some credits that you cannot take on Form 1040A or Form 1040EZ.

You must use Form 1040 if:

- Your taxable income is $50,000 or more.
- You received or paid accrued interest on securities transferred between interest payment dates.
- You received nontaxable dividends.
- You received capital gain distributions.
- You are required to complete Part III of Schedule B (Form 1040) because:
  At any time during the year you had an interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country, or
  You were a grantor of, or transferor to, a foreign trust that existed during 1990.
- You had income other than wages, salaries, tips, IRA distributions, pensions and annuities, taxable social security and railroad retirement benefits, unemployment compensation, interest, or dividends. This includes gain from the sale of your home or other property, barter income, alimony income, or self-employment income (including farm income).
- You itemize your deductions.
- You claim adjustments to gross income for payments for self-employed health insurance, deduction for self-employment tax, payments to a Keogh or SEP plan, penalty on early withdrawal of savings, alimony paid, certain required repayments of supplemental unemployment benefits, jury pay turned over to your employer, qualified performing artists' expenses, or amortization of costs of forestation/reforestation.
- Your Form W-2 shows uncollected employee tax (social security tax) on tips. See Chapter 7.
- You receive Alaska Permanent Fund dividends.
- You received $20 or more in tips in any one month, and you did not report all of these tips to your employer. See Chapter 7.
- You must pay tax on self-employment income. See Schedule SE (Form 1040), *Social Security Self-Employment Tax.*
- You have to repay an investment credit or a low-income housing credit you claimed in a previous year.
- You have to pay any section 72 penalty taxes, any alternative minimum tax, or any tax on an excess golden parachute payment.
- You claim credits against your tax for any of the following:
  Mortgage interest credit
  Foreign tax credit
  Investment credit
  Jobs credit
  Credit for prior year minimum tax
  Credit for alcohol used as fuel
  Credit for fuel from a nonconventional source
  Credit for federal tax on fuels
  Low-income housing credit
  Regulated investment company credit
  Credit for overpaid windfall profit tax
  Credit for increasing research activities
- You file any of the following:
  Form 2555, *Foreign Earned Income*
  Form 4469, *Excess Medicare Tax Credit* (for government employees and railroad employee representatives) (Chapter 35)
  Form 4563, *Exclusion of Income for Bona Fide Residents of American Samoa*
  Form 4970, *Tax on Accumulation Distribution of Trusts*
  Form 4972, *Tax on Lump-Sum Distributions* (Chapter 11)
  Form 5329, *Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts* (to pay tax on an IRA) (Chapter 19)
  Form 8271, *Investor Reporting of Tax Shelter Registration Number*
  Form 8814, *Parent's Election to Report Child's Interest and Dividends*

How to File

In most cases, the Internal Revenue Service (IRS) will mail you either Form 1040, Form 1040A, or Form 1040EZ with related instructions.

If you have not received a tax return package in the mail, or if you need other forms, you can order them. You can get most publications you need from the IRS Forms Distribution Center for your state by using the order blank at the end of this publication or by calling the toll-free number, 1–800–TAX–FORM (1–800–829–3676).

Substitute tax forms. You cannot use your own version of a tax form unless it meets the requirements explained in Publication 1167, *Substitute Printed, Computer-Prepared and Computer-Generated Tax Forms and Schedules.*

Tax help on videotape. A videotape of tax return instructions is available in either English or Spanish at participating libraries.

Electronic filing. If you are due a refund on your 1990 tax return, you may be able to have your return filed electronically instead of on a paper form. The electronic filing method can be used by many tax return preparers and other professional filers (who do not prepare returns but use this method to file returns already completed by taxpayers). These preparers and filers are equipped to send tax return information over telephone lines to an Internal Revenue Service Center. They will charge you for this service, but you will normally receive your refund sooner, and you may be able to have it deposited directly into your savings or checking account. Electronic filing is available to taxpayers in all 50 states.

Advantages. Electronic filing shortens the average time for processing returns to within 3 weeks. Electronic filing uses automation to replace most of the manual steps needed to process paper returns. As a result, processing for electronic returns is faster, less expensive, and more accurate. However, errors on the return or problems with its transmission or processing can delay your refund.

As with a paper return, you are responsible for making sure your return contains accurate information and is filed on time. Electronic filing does not affect your chances of an IRS audit of your return.

Form 8453. Your preparer will ask you to sign Form 8453, *U.S. Individual Income Tax Declaration for Electronic Filing.* Your preparer will file the form with the IRS. Your signature on the declaration form:

- Certifies that the information on Form 8453 is correct and corresponds to the information on your return,
- Authorizes your preparer to file your return electronically, and
- Authorizes the IRS to:
  a) Deposit your refund directly to your savings or checking account, and
  b) Notify your preparer whether the direct deposit request will be honored.

Form 8453 is not a power of attorney. It does not authorize your tax preparer to receive information from IRS about your tax account.

Your preparer will give you the required preparer-signed copy of your return, including a copy of the completed Form 8453. This material is for your records. Do not mail this copy to the IRS; if you do, your refund may be delayed.

Tele-Tax information. For more information on electronic filing, a recorded message is available on the Tele-Tax system. It is Topic Number 112 on the Recorded Tax Information. The Tele-Tax number for your area is located near the end of this publication. You can also call toll-free 1–800–TAX–1040

(1–800–829–1040) for more information. Ask for electronic filing information.

Refund inquiries. The IRS will notify your preparer of the date your electronic return was accepted for processing. If you do not receive your refund 4 weeks after the return was accepted by IRS, you can call Tele-Tax Automated Refund Information. The Tele-Tax number for your area is listed at the back of this publication. Before you call Tele-Tax, please have the following information from your return available:

- The first social security number shown on the return,
- Your filing status, and
- The exact amount of your refund.

If the Tele-Tax recording tells you the date your refund was issued, you should receive the refund within a week of that date. If you do not receive the refund by the end of that week, contact your IRS office. See the telephone numbers listed under *Call IRS With Your Tax Question*, at the back of this publication.

If Tele-Tax has no information on your return, contact your preparer for the date IRS accepted your return. If your return was accepted more than 4 weeks ago, contact your local IRS office. Explain that you filed your return electronically and that Tele-Tax has no information on it. Also, provide the first social security number shown on your return and the date the IRS accepted your return.

Direct deposit. To choose direct deposit of your refund, complete Part II of Form 8453. Your signature in Part III gives IRS your authorization to deposit the refund. Your signature also gives IRS permission to notify your preparer whether the direct deposit request will be honored.

Errors in direct deposit information will cause delays in processing your refund. Review the information carefully. Make sure the "routing transit number" (RTN) of your financial institution contains 9 digits. Your return will be rejected if there are less than 9 digits. If this occurs, your electronic filer will be notified.

Your request for direct deposit may not be honored if one of the following occurs:

- You owe federal tax, a student loan, child support, or debts to other federal agencies. (IRS will notify your electronic filer.)
- The IRS has certain special processing needs. (IRS will notify you and a paper check will be sent to you.)

Once an electronic return has been accepted by IRS, you cannot cancel the direct deposit election nor can you change your RTN or bank account number.

Address Label

After you have completed your return, peel your address label off the cover of your tax return package and place it in the address area of the Form 1040, Form 1040A, or Form 1040EZ you send to the IRS. If you have someone prepare your return, give that person your label to use.

The coding on the label is used by the IRS in processing your return. The label helps to correctly identify accounts. It also saves processing costs and speeds up processing so that refunds can be issued sooner.

Correcting the label. Make necessary name and address changes on the label. If you have an apartment number that is not shown on the label, please write it in. If you and your spouse file a joint return and maintain separate homes, choose one address to enter on your return. If the label is for a joint return and the social security numbers are not listed in the same order as the first names, change the numbers to show the correct order. If your social security number is not correct, or if you changed your name, see the discussion later under *Social Security Number*.

If you did not receive a tax return package with a label, print or type your name, address, and social security number in the spaces provided at the top of Form 1040 or Form 1040A. If you are married filing a separate return, do not enter your spouse's name in the space at the top. Instead, enter his or her name in the space provided on line 3.

If you file Form 1040EZ without a label, print (do not type) this information in the spaces provided.

P.O. box. If your post office does not deliver mail to your street address and you have a P.O. box, write your P.O. box number on the line for your present home address instead of your street address.

Foreign address. If your address is outside the United States or its possessions or territories, enter the information on the line for "City, state, and ZIP code" in the following order:

1) City,
2) Province or state,
3) Foreign postal code, and
4) Name of foreign country.

Do not abbreviate the country name.

Social Security Number

You must show your social security number (SSN) on your return. If the number shown on the address label on the tax return package you received in the mail is wrong, mark through it. Correct it on the label. Enter the correct number in the space provided on the return. If you did not receive a return with a label, print your number in the space provided on the return.

If you are married, give the social security numbers for both you and your spouse, whether you file jointly or separately.

Changed name. If you changed your name because of marriage, divorce, etc., make sure you immediately notify your Social Security Administration (SSA) office so the name on your tax return is the same as the one the SSA has on its records. This may prevent delays in issuing your refund and safeguard future social security benefits.

Dependent's social security number. If you claim an exemption for a dependent who is at least 2 years old by December 31, 1990, you must list the dependent's SSN on Form 1040 or Form 1040A. The social security number requirement applies to ***all dependents*** (not just your children) claimed on the tax return who are at least 2 years old.

No social security number. If you or your dependent who is at least 2 years old do not have an SSN, file a **Form SS–5** with your local SSA office. If you are a U.S. citizen, you must show proof of age, identity, and citizenship with your Form SS–5. If you are 18 or older, you must appear in person.

Form SS–5 is available at any SSA office. If you have any questions about which documents you can use as proof of age, identity, or citizenship, contact your SSA office.

If you or your dependent do not receive a number by the time you are ready to file, you should file your return and write *"Applied for"* in the space provided for the number.

Nonresident alien dependents. If you claim dependents who are residents of Mexico or Canada, they must have an SSN. You may apply for an SSN with either the Social Security Administration or a U.S. consulate or embassy. See *Social Security Number for Dependents* in Chapter 3 for more information.

Nonresident alien spouse. If your spouse is a nonresident alien and you file a joint return, your spouse must get a social security number. If your spouse does not receive an SSN by the time you are ready to file, see *No social security number*, earlier, for further instructions.

If you file a separate return and your spouse does not have an SSN or any income, then write "NRA" in the space provided for your spouse's number.

You may have to pay a penalty if you do not give your social security number to another person when you are required to. See *Penalties*, later.

If you write to the IRS about your tax account, be sure to include your social security number in your correspondence. Your social security number is used to identify your account and expedite the processing of your correspondence.

Presidential Election Campaign Fund

This fund was set up to help pay for presidential election campaigns.

You may have $1 of your tax liability go to this fund by checking the *Yes* box on Form 1040, Form 1040A, or Form 1040EZ. If you are filing a joint return, your spouse may also have $1 go to the fund.

If you check *Yes*, it will not change the tax you pay or the refund you will receive.

Rounding Off Dollars

You may round off cents to whole dollars on your return and schedules. If you do round to whole dollars, you must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar. For example, $1.39 becomes $1 and $2.50 becomes $3.

If you have to add two or more amounts to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

Example. You receive two W–2 forms: one showing wages of $5,000.55 and one showing wages of $18,500.73. On Form 1040, line 7, you would enter $23,501 ($5,000.55 + $18,500.73 = $23,501.28) instead of $23,502 ($5,001 + $18,501).

Additional Schedules

Depending on the form you file and the items reported on your return, you may have to complete additional schedules and attach them to your return.

If you file Form 1040EZ, no additional schedules are necessary.

If you file Form 1040A, you must attach and complete (if they apply to you) Schedules 1, 2, and 3 listed here.

- Schedule 1, Part I, to report your ***interest income*** if it is more than $400.

- Schedule 1, Part II, to report your ***dividend income*** if it is more than $400.
- Schedule 2, Parts I, II, and III, to take the ***credit for child and dependent care expenses.***
- Schedule 3, Parts I, II, and III, to take the ***credit for the elderly or the disabled.***

If you file Form 1040, attach the necessary schedules or forms, such as:

- Schedule A to show your ***itemized deductions.***
- Schedule B to report ***interest and dividends*** (including capital gain and nontaxable distributions) if either is more than $400, or to answer the ***foreign accounts*** and ***foreign trusts*** questions.
- Schedule C to report profit or loss from your ***business or profession.***
- Schedule D to report ***capital gains and losses,*** and to reconcile Form(s) 1099–B to your return.
- Schedule E to report income or loss from ***rents, royalties, partnerships, estates, trusts, S corporations, and REMICs (residual interests).***
- Schedule F to report ***farm income and expenses.***
- Schedule R if you claim the ***credit for the elderly or the disabled.***
- Schedule SE to figure ***self-employment tax.***

Assembling your return. Attach all forms and schedules in order of the "Attachment Sequence Number" shown in the upper right corner of the form or schedule. Attach all other statements or attachments at the end of your return, even if they relate to another form or schedule.

If you owe tax, be sure to attach your payment in the place indicated on the front of your Form 1040, Form 1040A, or Form 1040EZ.

Foreign financial accounts and foreign trusts. You must complete Part III of Schedule B (Form 1040) if:

1) You received more than $400 in either interest or dividends, or
2) You had a foreign account or were the grantor of, or transferor to, a foreign trust.

If you checked *Yes* to the question on line 11a, Part III of Schedule B, file Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts,* by June 30, 1991, with the Department of the Treasury at the address shown on the form. Form TD F 90–22.1 is not a tax return, so do not attach it to your Form 1040. Be sure to file your Form 1040 with the IRS. You can get Form TD F 90–22.1 by using the order blank at the end of this publication.

For more information, see the instructions for Part III of Schedule B (Form 1040).

Form W–2. Form W–2, *Wage and Tax Statement,* is a statement from your employer of the wages and other compensation paid to you and the taxes withheld from your pay. If you worked for more than one employer during the year, you should have a Form W–2 from each employer. Be sure to attach the first copy or copy B of Form W–2 in the place indicated on the front of your return. For more information, see *Form W–2* in Chapter 5.

Signatures

You must sign and date your return. If you file a joint return, both you and your spouse must sign the return, even if only one of you had income.

If you prepare your own return, leave the space under your signature blank. If another person prepares your return and does not charge you, that person should not sign your return.

Paid preparer. Generally, anyone who is paid to prepare, assist in preparing, or review your tax return must sign it and fill in the other blanks in the paid preparer's area of your return. Paid preparers of Form 1040EZ must sign the return and provide all other required information at the bottom of the form below the area for the taxpayer's signature.

If the preparer is self-employed (that is, not employed by any person or business to prepare the return), he or she should check the self-employed box in the *Paid Preparer's Use Only* space on Form 1040 or Form 1040A.

The person required to sign your return must fill in the required preparer information and sign in the space provided for the preparer's signature. Signature stamps and labels are not acceptable. The preparer must also give you a copy of your return in addition to the copy filed with the IRS.

If you have questions about whether a preparer must sign your return, please contact any IRS office.

Occupations. If you file Form 1040 or Form 1040A, enter your occupation in the space provided in the signature section. If you file a joint return, enter both your occupation and your spouse's occupation.

Signing for taxpayer. A taxpayer can appoint an agent to sign the return if the taxpayer is:

1) Unable to sign the return because he or she has a disability,
2) Absent from the United States for a continuous period of at least 60 days before the due date for filing the return, or
3) Given permission to do so by the IRS district director in the taxpayer's district.

A return signed by an agent in any of these cases must have a power of attorney attached that authorizes the agent to sign for the taxpayer.

Individuals with disabilities. If you sign a tax return for an individual with disabilities (a parent with disabilities, for example), you must attach a power of attorney (POA) to the return. You can use a POA specifically designed for the individual with disabilities that states you are granted authority to sign the return, or you can use Form 2848, *Power of Attorney and Declaration of Representative.* Part I of Form 2848 must state you are granted authority to sign the return. If you are filing a joint return and your spouse has a disability, see *Signing a joint return* in Chapter 2.

Unable to sign. If the taxpayer is mentally incompetent and cannot sign the return, it must be signed by a court-appointed representative who can act for the taxpayer.

If the taxpayer is mentally competent but physically unable to sign the return or POA, a valid "signature" is defined under state law. It can be anything that clearly indicates the taxpayer's intent to sign. For example, the taxpayer's "X" with the signatures of two witnesses might be considered a valid signature under a state's law.

Dependent child. If a child is required to file a tax return but cannot sign the return, the child's parent, guardian, or another legally responsible person must sign the child's name, followed by the words "By (signature), parent (or guardian) for minor child."

Accounting Periods and Methods

You must figure your taxable income for a fixed period of time. This time is called an accounting period. You must account for your income and deductions in a way that clearly shows your taxable income. The way you account is called an accounting method.

Accounting Periods

Most individual tax returns cover a ***calendar year***—the 12 months from January 1 through December 31. This is one accounting period. Another is the ***fiscal year*** —a 12–month period that ends on the last day of any month except December.

You must choose your accounting period when you file your first income tax return. It cannot be longer than 12 months. To change your accounting period, you must get permission from the IRS. If you want to change your accounting period, get **Form 1128,** *Application to Adopt, Change or Retain a Tax Year.*

Example. During 1989 you were an employee and earned $15,000. You filed your 1989 income tax return on a calendar year basis. On July 1, 1990, you quit your job and opened your own repair shop. For business reasons, you want to file your income tax return on a fiscal year basis from July 1, 1990, to June 30, 1991. To change your accounting period, complete and submit Form 1128. The new period cannot be used until you receive approval from IRS.

For more information on accounting periods, see Publication 538, *Accounting Periods and Methods.*

Accounting Methods

Your accounting method is the way you account for your income and deductions. The two accounting methods used most often are the cash method and the accrual method.

The cash method. If you use this method, report all items of income in the year in which you actually or constructively receive them. Deduct all expenses in the year you pay them. This is the method most individual taxpayers use.

Income is constructively received when it is credited to your account, or is set apart in any way that makes it available to you. You do not need to have physical possession of it. For example, dividends or interest credited to your account by a bank or savings and loan association on December 31, 1990, are taxable income to you in 1990 if you could have withdrawn them in 1990 (even if the amount is not entered in your passbook or withdrawn until 1991).

Garnisheed wages. If your employer uses your wages to pay your debts, or if your wages are attached or garnisheed, the full amount is constructively received by you. You must include these wages in income for the year you would have received them.

Brokerage and other accounts. Profits from a brokerage account, or similar account, are fully taxable in the year you earn them. This is true even if:

1) You do not withdraw the earnings,
2) The credit balance in the account may be reduced or eliminated by losses in later years, or
3) Current profits are used to reduce or eliminate a debit balance from previous years.

If another person cancels or pays your debts (but not as a gift or loan), you have constructively received the amount and must include it in your gross income for the year.

If a third party is paid income from property you own, you have constructively received the income. It is the same as if you had actually received the income and paid it to the third party.

Income received by an agent for you is income constructively received by you in the year the agent receives it. If you indicate in a contract that your income is to be paid to another person, you must include the amount in your gross income when the other person receives it.

A valid check you received or that was made available to you before the end of the tax year is constructively received by you in that year, even if you do not cash the check or deposit it in your account until the next year.

No constructive receipt. There may be facts to show that you did not constructively receive income.

Example. Alice Johnson, a teacher, agreed to her school board's condition that, in her absence, she would receive only the difference between her regular salary and the salary of a substitute teacher hired by the school board. Therefore, Alice did not constructively receive the amount by which her salary was reduced to pay the substitute teacher.

The accrual method. If you use this method, you report income when you earn it, whether or not you receive it. You deduct your expenses when you incur them, rather than when you pay them.

Prepaid income is generally included in gross income in the year you receive it. Your method of accounting does not matter as long as the income is available to you. Prepaid income includes rents or interest received in advance and compensation for services to be performed later.

Advance payments for services. If, under an agreement, you receive advance payment for services to be performed by the end of the next tax year, you can defer these payments from income until you earn them by performing the service. You ***must*** be an accrual method taxpayer to defer advance payments. You cannot defer them beyond the year after the year you receive them. For more information, get Publication 538.

Changing your accounting method. Once you have chosen your accounting method, you ordinarily cannot change it without the permission of the IRS. However, you can use a different method for each business you have.

Example. You work for a salary and use the cash method to report that income on your tax return. You open a gift shop and continue to work for a salary. Even though you use the cash method for your salary, you can use the accrual method for reporting income from your gift shop.

If you want to change your accounting method, get Form 3115, *Application for Change in Accounting Method.* For more information on accounting methods, get Publication 538.

When to File

April 15, 1991, is the final date for filing your 1990 income tax return if you use a calendar year. If you use a fiscal year (a year ending on the last day of any month except December, or a 52/53 week year), your income tax return is due by the 15th day of the 4th month after the close of your fiscal year.

When the due date for doing ***any*** act for tax purposes—filing a return, paying taxes, etc.—falls on a Saturday, Sunday, or legal holiday, you can do that act on the next business day.

Your return is filed on time if it is properly addressed and postmarked no later than the due date. The return must have sufficient postage. If you send a return by registered mail, the date of the registration is the postmark date. The registration is evidence that the return was delivered. If you send a return by certified mail and have your receipt postmarked by a postal employee, the date on the receipt is the postmark date. The postmarked certified mail receipt is evidence that the return was delivered.

If you do not file your return by the due date, you may have to pay a failure-to-file penalty and interest. See *Penalties*, later.

If you are a nonresident alien and earn wages that are subject to U.S. income tax withholding, your 1990 U.S. income tax return is due April 15, 1991, if you file on a calendar year basis, or the 15th day of the 4th month after the end of your fiscal year. If you do not earn wages that are subject to U.S. income tax withholding, file your return by June 17, 1991, if you file on a calendar year basis, or by the 15th day of the 6th month after the end of your fiscal year.

If you must file a final return as an executor, administrator, legal representative, or surviving spouse of a taxpayer who died during the year, the income tax return is due on the 15th day of the 4th month after the end of the deceased taxpayer's normal tax year. See *The Final Return* in Chapter 4. In most cases, for a 1990 return this will be April 15, 1991.

Extensions of Time to File

If you ask for an extension of time to file your return, you cannot use Form 1040EZ or have the IRS figure your tax.

Automatic extension of time to file. You can get an automatic 4–month extension of time to file your 1990 Form 1040A or Form 1040. To get the automatic extension, you must file Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return.*

When to file. You must file Form 4868 by April 15, 1991, with the Internal Revenue Service Center for your area. If you are filing a fiscal year return, file Form 4868 by the regular due date for your return. You can file Form 1040A or Form 1040 any time before the 4–month extension period ends.

Note. Any extension of time granted for filing your 1990 calendar year income tax return also extends the time for filing a 1990 gift tax return.

An extension of time to file is not an extension of time to pay. You must make an estimate of your tax for the year and pay any tax due with Form 4868. There is a penalty for paying the tax late unless you have reasonable cause for not paying your tax when due.

When you file your return, enter any payment you made with Form 4868 on line 58, Form 1040. If you file Form 1040A, include in the total on line 28d the amount paid with Form 4868. Also write "Form 4868" and the amount in the space to the left of line 28d.

If you underestimated the amount you owe, you have to pay interest on the unpaid amount. You may have to pay, in addition to interest, a failure-to-pay penalty discussed later. Any interest or penalty applies from the original due date of the return, which is usually April 15.

Extensions beyond the automatic 4–month extension of time to file are granted only for very good reasons. An extension of more than 6 months will not be granted if you are in the United States. However, if you are outside the United States, you may be granted a longer extension. See *Filing Requirements* in Publication 54.

You can apply for an extension beyond the 4–month extension either in a letter or by filing **Form 2688,** *Application for Additional Extension of Time To File U.S. Individual Income Tax Return.* You should request the extension early so that, if refused, you will still be able to file on time. Except in cases of undue hardship, Form 2688 or a request by letter will not be accepted until you have first used Form 4868 to get an automatic 4–month extension. Form 2688 or your letter will not be considered if you file it after the extended due date.

To get an extension beyond the automatic 4–month extension, you must give all the following information:

- The reason for requesting the extension.
- The tax year to which the extension applies.
- The length of time needed for the extension.
- Whether another extension of time to file has already been granted for this tax year.

You may sign the request for this extension, or it may be signed by your attorney, CPA, enrolled agent, or a person with a power of attorney. If you are unable to sign the request because of illness or for another good reason, a person in close personal or business relationship to you can sign for you, stating why you could not sign the request.

If your application for this extension is approved, you will be notified by the IRS. Attach the notice to your return when you file it.

If an extension is granted and the IRS later determines that the statements made on your request for this extension are false and misleading and an extension would not have been granted at the time based on the true facts, the extension is null and void. You will have to pay the failure-to-file penalty (discussed later).

If your application for this extension is not approved, you must file your return by the extended due date of the automatic extension. You may be allowed to file within 10 days of the date of the notice you get from the IRS if the end of the 10–day period is later than the due date. The notice will tell you if the 10–day grace period is granted.

Extensions—Special Rule

If you are a U.S. citizen or resident living outside of the United States and Puerto Rico and your main place of business or post of duty is outside the United States and Puerto Rico on April 15, 1991, you are allowed an automatic extension until June 17, 1991, to file your return and pay any tax due for 1990. If you file your return on a fiscal year basis, you are allowed a 2-month extension beyond the regular due date of your return.

Married taxpayers. If you file a joint return, only one spouse must qualify for this automatic extension to apply. If you and your spouse file separate returns, this automatic extension applies only to the spouse who qualifies.

Military personnel on duty outside the United States and Puerto Rico on April 15, 1991, are allowed an automatic 2-month extension of time for filing a return and paying federal income tax.

If you use this automatic extension, you must attach a statement to your return explaining the situation that qualified you for the extension. Interest must be paid on any tax due starting from the original due date of the return until the date the tax is finally paid.

If you need additional time, you can get an additional automatic 2-month extension of time to file your return. You must file Form 4868 by June 17, 1991, to get the extension. This additional 2-month extension of time to file is *not* an extension of time to pay any tax you may owe. You must make an estimate of your tax for the year and pay any tax due with Form 4868.

U.S. citizens living abroad should get Publication 54 for more information.

Refunds

If you overpay your income tax, you can get a refund of the amount you overpaid. However, you can choose to apply all or part of the overpayment to your next year's (1991) estimated tax by using Form 1040 or Form 1040A.

If you use Form 1040 and you overpaid your tax, show on line 63 the amount you overpaid. Show on line 64 the amount you want refunded. Show on line 65 the amount of your overpayment (if any) you want applied to your 1991 estimated tax. If you use Form 1040A and you overpaid your tax, show on lines 30 and 31 the amount you want refunded and the amount you want to apply to your 1991 estimated tax. If you use Form 1040EZ and you overpaid your tax, show your refund on line 8. You cannot have your overpayment applied to your 1991 estimated tax if you file Form 1040EZ.

A refund of less than one dollar will not be made unless you request it on a separate statement attached to your return.

Note. U.S. Government checks must now be cashed within 12 months of the date they are issued. Checks not cashed within 12 months will be canceled and the proceeds returned to the IRS. Cash your tax refund check soon after you receive it.

If your check has been canceled, you may apply to IRS to have it reissued.

Interest

If you are due a refund, no interest will be paid if the refund is made within 45 days of the due date of the return. If you file your return after the due date (including extensions), no interest will be paid if the refund is made within 45 days of the date you filed. If the refund is not made within this 45-day period, interest will be paid from the due date of the return or from the date you filed, whichever is later.

For purposes of determining if any interest is due on a refund, your return will not be treated as filed until it:

1) Is filed on a permitted form,
2) Contains information that identifies you,
3) Is signed by you, and
4) Contains sufficient information for mathematical verification of the tax liability shown on the return.

Accepting a refund check does not change your right to claim an additional refund and interest. File your claim within the applicable period of time. See *Amended Returns and Claims for Refund,* later. If you do not accept a refund check, no more interest will be paid on the amount of the overpayment included in the check.

Interest on erroneous refund. All or part of any interest you were charged on an erroneous refund will generally be forgiven. Any interest charged for the period before demand for repayment was made will be forgiven unless:

1) You, or a person related to you, caused the erroneous refund in any way, or
2) The refund is more than $50,000.

For example, if you claimed a refund of $100 on your return, but the IRS made an error and sent you $1,000, you would not be charged interest for the time you held the $900 difference. You must, however, repay the $900 when requested by the IRS.

Offset Against Debts

If you are due a refund but have not paid certain obligations, all or part of your overpayment of tax may be used to pay all or part of the past-due amount. This includes past-due income tax, other federal debts (such as student loans), child and spousal support payments. See *Reduced refund,* under *Amended Returns and Claims for Refund,* later.

Joint return. When a joint return is filed, and only one spouse is obligated to pay past-due child and spousal support or a federal debt, the spouse who is not obligated for the debt can be considered an ***injured spouse.*** An injured spouse can obtain a refund for his or her share of the overpayment that would otherwise be used to pay the past-due amount.

To be considered an injured spouse, you must:

1) File a joint return.
2) Have received income (such as wages, interest, etc.).
3) Have made payments (such as federal income tax withheld from wages or estimated tax payments).
4) Report the income and payments on the joint return.
5) Have an overpayment, all or part of which may be applied against the past-due amount.

If you are an injured spouse, you can obtain your portion of the joint refund by completing Form 8379, *Injured Spouse Claim and Allocation.* Follow the instructions on the back of the form.

Change of Address

If you move or otherwise change your mailing address, be sure to notify the Internal Revenue Service by using **Form 8822,** *Change of Address.* Mail it to the Internal Revenue Service Center for your old address. Addresses for the Service Centers are on the back of the form. If you are changing both your home and business address, you should complete two separate forms.

If you move after filing your return and you are expecting a refund, you should notify both the post office serving your old address and the Service Center where you filed your return. This will help in forwarding your check to your new address.

Be sure to include your social security number (and the name and social security number of your spouse, if you filed a joint return) in any correspondence with the IRS.

Past-Due Refund

If you do not get your refund within 8 weeks after filing your return, call your IRS office or write to the Service Center where you filed your return. Be sure to include your name, address, daytime telephone number, and social security number (and the name and social security number of your spouse, if you filed a joint return) in any letter you send to the IRS. Also have the social security number(s) available if you call the IRS.

Telephone service for tax refund information. You may be able to call a telephone number for your area to find out the status of your income tax refund. For details on how to use this telephone service, see *What is Tele-Tax?* at the end of this publication. Please wait 8 weeks after filing your 1990 tax return before using this service. However, if you filed your return electronically, see *How to File,* earlier, for information about refund inquiries when you file an electronic return.

Amount You Owe

If you owe additional tax, you should pay it with your return. If you owe less than one dollar, you need not pay it.

If the IRS figures your tax, you will receive a bill for any tax that is due. You should pay this bill within 30 days.

If you do not pay your tax by the due date, you may have to pay a failure-to-pay penalty. See *Penalties,* later.

Interest will be charged on taxes not paid by their due date, even if you get an extension of time for filing.

For underpayments, the interest rate for 1990 is 11%.

For overpayments, the interest rate for 1990 is 10%.

The interest is compounded daily.

Interest on penalties. Interest will also be charged on some penalties, including the failure-to-file penalty and the accuracy-related penalty. Interest is imposed on these penalties as of the due date of the return (including extensions) to the date of payment. Interest on other penalties starts on the date of notice and demand.

Interest on deficiency suspended. If you are (or were) charged compounded interest on a deficiency for any period during which regular interest on the deficiency is suspended, you can claim a refund of the compounded interest

paid for that period. You can file a claim on Form 843, *Claim for Refund and Request for Abatement*, for such interest.

Interest due to IRS error or delay. All or part of any interest you were charged for a deficiency or payment can be forgiven if the interest is due to an error or delay by an officer or employee of the IRS in performing a ministerial act. This is a procedural or mechanical act that occurs during the processing of a taxpayer's case.

The interest can be forgiven only if you are not responsible in any important way for the error or delay and the IRS has notified you in writing of the deficiency or payment. For more information, get Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund.*

Estimated tax. If you file your tax return and pay your 1990 tax in full by January 31, 1991, you do not have to pay the 4th installment of your estimated tax.

Farmers and fishermen who are required to make only one payment of estimated tax (by January 15, 1991) do not need to make that payment if they file Form 1040 and pay the tax in full for the 1990 calendar year by March 1, 1991.

Fiscal year taxpayers. If you are a fiscal year taxpayer, you have until the last day of the first month following the close of your fiscal year to file your tax return and pay the tax. (Farmers and fishermen have until the first day of the 3rd month.)

How to pay. If you pay by check or money order, make it out to *Internal Revenue Service.* Please write your correct name, address, social security number, form number, daytime telephone number, and tax year on the front of your check or money order.

For example, during 1991 you file your Form 1040 for 1990 and you owe additional tax. Write your social security number, daytime telephone number, and *1990 Form 1040* on your check or money order. If you file an amended return (Form 1040X) for 1989 and you owe tax, write your social security number, daytime telephone number, and *1989 Form 1040X* on the front of your check or money order. Be sure to attach your payment to the front of your return.

Your tax is not paid until your check or money order is paid (IRS receives the funds from your bank, etc.).

Do not mail cash with your return. If you pay cash at an IRS office, keep the receipt as part of your records.

Do not include any estimated tax payment in your check or money order that is for payment of your 1990 taxes. Mail the estimated tax payment separately to the address shown in the Form 1040–ES instructions. The address for mailing estimated tax payments may be different from the address where you send your tax return.

Gift to Reduce the Public Debt

You can make a gift to reduce the public debt. If you wish to do so, enclose a *separate* check in the envelope with your income tax return, and make it payable to *Bureau of the Public Debt.* You can deduct this gift on next year's tax return if you itemize your deductions. Please do not add it to any tax you owe. Include a separate check payable to *Internal Revenue Service* for the tax owed.

Penalties

To ensure that all taxpayers pay their fair share of taxes, the law provides penalties for failure to file returns or pay taxes as required.

Criminal Penalties

You may be subject to criminal prosecution (brought to trial) for actions such as:

1) Tax evasion.
2) Willful failure to file a return, supply information, or pay any tax due.
3) Fraud and false statements.
4) Preparing and filing a fraudulent return.

Civil Penalties

If you do not file your return and pay your tax by the due date, you may have to pay a penalty. You may also have to pay a penalty if you substantially understate your tax, file a frivolous return, or fail to supply your social security number. If you provide fraudulent information on your return, you may have to pay a civil fraud penalty.

Filing Late

If you do not file your return by the due date (including extensions), you may have to pay a ***failure-to-file*** penalty. The penalty is based on the tax not paid by the due date (without regard to extensions). The penalty is usually 5% for each month or part of a month that a return is late. The failure-to-file penalty generally cannot be more than 25% of your tax.

Return over 60 days late. If you file your return more than 60 days after the due date or extended due date, the penalty will be at least $100 or 100% of the balance of tax due, whichever is smaller.

Fraud. If your failure to file is due to fraud, the penalty is 15% for each month or part of a month that your return is late, up to a maximum of 75% of your tax.

Exception. You will not have to pay the penalty if you show that you failed to file on time because of reasonable cause and not because of willful neglect. See *Extensions of Time to File*, earlier.

Paying Tax Late

You will have to pay a ***failure-to-pay*** penalty of ½ of 1% of your unpaid taxes for each month, or part of a month, after the due date that the tax is not paid. If a notice of intent to levy is issued, the rate will increase to 1% at the start of the first month beginning at least 10 days after the day that the notice is issued. If a notice and demand for immediate payment is issued, the rate will increase to 1% at the start of the first month beginning after the day that the notice and demand is issued.

This penalty cannot be more than 25% of your unpaid tax. You will not have to pay the penalty if you can show that you had a good reason for not paying your tax on time. This failure-to-pay penalty is added to interest charges on late payments.

Combined penalties. If both the failure-to-file and the failure-to-pay penalty (discussed earlier) apply in any month, the 5% (or 15%) failure-to-file penalty is reduced by the failure-to-pay penalty. However, if you file your return more than 60 days after the due date or extended due date, the penalty will not be reduced below $100 or 100% of the tax due, whichever is smaller.

Accuracy-Related Penalty

You may have to pay an accuracy-related penalty if (1) there is any underpayment of tax on your return due either to negligence or disregard of rules or regulations or (2) if you substantially understate your income tax. The penalty is equal to 20% of the underpayment. Each term is discussed later.

The penalty will not be figured on any part of an underpayment on which a fraud penalty (discussed later) is charged.

Negligence. The term "negligence" includes a failure to make a reasonable attempt to obey rules. The term "disregard" includes any careless, reckless, or intentional disregard.

The penalty is based on the part of the underpayment due to negligence or disregard of rules or regulations, not on the entire underpayment on the return.

Adequate disclosure. The accuracy-related penalty may be avoided if you adequately disclose a nonfrivolous position on the return or can show reasonable cause and good faith for the tax treatment of a particular item.

To make this "good faith" disclosure, you can use Form 8275, *Disclosure Statement*, or make the disclosure on the return.

If you choose to make the disclosure on the return, the statement **"Disclosure Made Under Section 6662"** must appear at the top left-hand corner on the front of the return. Clearly refer to the page or line number containing the disclosure. Then go to that page or line number and describe the relevant facts about the tax treatment of the item. Merely filling out the line on the return is not sufficient.

Substantial understatement of income tax. You understate the tax if the tax shown on your return is less than the correct tax. You substantially understate your tax if the understatement is more than 10% of the correct tax or $5,000, whichever is larger.

Substantial authority. If there is or was substantial authority to support the tax treatment of the item on your return that caused the understatement, the understatement may be reduced. For tax shelter items, this exception applies only if the tax treatment was more likely than not the correct treatment.

Whether there is or was substantial authority depends on the facts and circumstances. Consideration will be given to court opinions, Treasury regulations, revenue rulings, and revenue procedures that involve the same or similar circumstances as yours.

Adequate disclosure. Except in the case of a tax shelter item, the understatement may also be reduced if you have adequately disclosed on the return or an attached statement, the relevant facts about the tax treatment of the item. To make this disclosure, you can use Form 8275 or your own statement as required on Form 8275. See *Adequate disclosure* under *Negligence* earlier for further information.

Reasonable cause. You will not have to pay a penalty if you show a good reason (reasonable cause) for giving special tax treatment to a particular item.

Penalty for frivolous return. You may have to pay a penalty of $500 if you file a frivolous return. A frivolous return is one that does not

include enough information to figure the correct tax or that contains information clearly showing that the tax you reported is substantially incorrect.

You will have to pay the penalty if you filed this kind of return because of a frivolous position on your part or a desire to delay or interfere with the administration of federal income tax laws. This includes altering or striking out the preprinted language above the space provided for your signature.

This penalty is added to any other penalty provided by law.

The penalty must be paid in full upon notice and demand from Internal Revenue Service even if you protest the penalty.

Fraud penalty. If there is any underpayment of tax on your return due to fraud, a penalty of 75% of the underpayment due to fraud will be added to your tax.

Joint return. The fraud penalty on a joint return applies to each spouse only to the extent the underpayment is due to the fraud of that spouse.

Penalty for failure to supply social security number. If you do not include your social security number, or the social security number of another person, including your dependent, where required on a return, statement, or other document, (other than returns or statements related to interest, dividends, or patronage dividends), you will be subject to a penalty of $50 for ***each*** failure. You will also be subject to the $50 penalty if you do not give your social security number to another person when it is required on a return, statement, or other document.

For example, if you have a bank account that earns interest, you must give your social security number to the bank. The number must be shown on the Form 1099–INT or other statement the bank sends you. If you do not give the bank your social security number, you will be subject to the penalty of $50. (You also may be subject to "backup" withholding of income tax. See Chapter 5.)

The maximum penalty is $100,000 for any calendar year. However, you will not have to pay the penalty if you are able to show that the failure was due to reasonable cause and not willful neglect.

Penalty for failure to furnish tax shelter registration number. A person who sells (or otherwise transfers) to you an interest in a tax shelter must give you the tax shelter registration number or be subject to a $100 penalty. If you claim any deduction, credit, or other tax benefit because of the tax shelter, you must attach Form 8271, *Investor Reporting of Tax Shelter Registration Number,* to your return to report this number. You will have to pay a penalty of $250 for each failure to report a tax shelter registration number on your return. The penalty can be excused if you have a reasonable cause for not reporting the number.

Amended Returns and Claims for Refund

You should correct your return if, after you have filed it, you find that:

1) You did not report some income,
2) You claimed deductions or credits you should not have claimed, or
3) You did not claim deductions or credits you could have claimed.

If you need a copy of your return, see *Keep copies of tax returns* under *Recordkeeping,* later in this chapter.

Form 1040X, *Amended U.S. Individual Income Tax Return,* is the form to use to correct the Form 1040, Form 1040A, or Form 1040EZ you have already filed.

Completing the return. On Form 1040X, write your income, deductions, and credits as you originally reported them on your return, the changes you are making, and the corrected amounts. Then figure the tax on the corrected amount and the amount you owe or your refund. If you owe tax, you must pay the full amount with Form 1040X. The tax owed will not be subtracted from any refund you have not yet received or from any amount you had credited to your 1991 estimated tax. If you overpaid tax, a refund will be sent separately from any refund shown on your original return.

Filing the return. After you finish your Form 1040X, check it to be sure that it is complete. Do not forget to show the year of your original return and explain all changes you made. Be sure to attach any forms or schedules needed to explain your changes. Mail your Form 1040X to the Internal Revenue Service Center serving the area where you now live (as shown in the instructions to the form).

A separate form must be filed for each tax year or period involved.

Time for filing a claim for refund. Generally, you must file your claim for a credit or refund within 3 years from the date your original return was filed or within 2 years from the date the tax was paid, whichever is later. Returns filed before the due date are considered to have been filed on the due date.

If the due date for filing a return or claiming a credit or refund is a Saturday, Sunday, or legal holiday, the return or claim is considered timely filed if it is filed on the next business day.

If you do not file a claim within this period, you may not be entitled to a credit or a refund.

Limit on amount of refund. If you file your claim within 3 years after the date you filed your return, the credit or refund cannot be more than the part of the tax paid within the 3 years (plus any extension of time for filing your return) before you filed the claim.

Example 1. You made estimated tax payments of $500 and got an automatic extension of time to August 15, 1987, to file your 1986 income tax return. When you filed your return on that date, you paid an additional $200 tax. Three years later, on August 15, 1990, you file an amended return and claim a refund of $700. Because you filed within the 3 years plus the 4–month extension period, you could get a refund of $700.

Example 2. The situation is the same as in Example 1, except you filed your return on October 31, 1987, 2½ months after the extension period ended. You paid an additional $200 on that date. Three years later, on October 25, 1990, you file an amended return and claim a refund of $700. Although you filed your claim within 3 years from the date you filed your original return, the refund is limited to $200. The estimated tax of $500 was paid before the 3 years plus the 4–month extension period.

If you file a claim after the 3–year period, but within 2 years from the time you paid the tax, the credit or refund cannot be more than the tax you paid within the 2 years immediately before you file the claim.

Example. You filed your 1986 tax return on April 15, 1987. You paid taxes of $500. On November 3, 1988, after an examination of your 1986 return, you had to pay an additional tax of $200. On May 2, 1990, you file a claim for a refund of $300. However, your refund will be limited to the $200 you paid during the 2 years immediately before you filed your claim.

Exceptions for special types of refunds. If you file a claim for one of the items listed below, the dates and limits discussed earlier (under *Time for filing a claim for refund* and *Limit on amount of refund*) may not apply. These special types of refunds are:

- A bad debt.
- A worthless security.
- Foreign tax paid or accrued.
- Net operating loss carryback.
- Carryback of certain tax credits.
- A claim based on an agreement with the Service extending the period for assessment of tax.
- An injured spouse claim.

Processing claims for refund. It often takes 2 to 3 months to process a claim. Your claim may be accepted as filed or may be subject to examination. If a claim is examined, the procedures are the same as in the examination of a tax return.

However, if you are filing a claim for a credit or refund based solely on contested income tax or on estate tax or gift tax issues considered in your previously examined returns and you want to take your case to court instead of appealing it within the Service, you should request in writing that the claim be immediately rejected. A notice of claim disallowance will then be promptly sent to you. You have 2 years from the date of mailing of the notice of disallowance to file a refund suit in the United States District Court having jurisdiction or in the United States Claims Court.

Reduced refund. Your refund may be reduced by an additional tax liability that has been assessed against you.

Also, your refund may be reduced by amounts you owe for past-due child support or debts to another federal agency. The IRS will notify you if this happens. The refund procedures discussed in this chapter will not be available to you to get back the reduction. However, if you are the spouse of a person who owes past-due amounts for these obligations and the reduced refund relates to an overpayment on a joint return, you may be able to get a refund of your share of the overpayment before it is used to pay the past-due amount. See *Offset Against Debts,* earlier.

Note. If your return is changed for any reason, it may affect your state income tax liability. This includes changes made as a result of an examination of your return by the IRS. Contact your state tax agency for more information.

Where to File

Use the addressed envelope that came with your return. If you do not have an addressed envelope or if you moved during the year, mail your return to the Internal Revenue Service Center for the area where you now live. The street address of the Service Center is not needed. A list of Service Center addresses is shown on the back cover.

Recordkeeping

You must keep records so that you can prepare a complete and accurate income tax return. The law does not require any special form of records. However, you should keep all receipts, canceled checks, and other evidence to prove amounts you claim as deductions or credits.

If you file a claim for refund, you must be able to prove by your records that you have overpaid your tax. Records to support your claim must be maintained for a period of at least 4 years after you file the claim.

You must keep your records for as long as they are important for any Internal Revenue law.

Keep records that support an item of income or a deduction appearing on a return until the period of limitations for the return runs out (a period of limitations is the limited period of time after which no legal action can be brought). Usually this is 3 years from the date the return was due or filed, or 2 years from the date the tax was paid, whichever date is later. However, if income that should have been reported on your return was not reported, and it is more than 25% of the income shown on the return, the period of limitations does not run out until 6 years after the return was filed. If a return is false or fraudulent with intent to evade tax, or if no return is filed, an action can generally be brought at any time.

In property transactions, the basis of new or replacement property may depend on the basis of the old property. See Chapter 15. Keep the records of transactions relating to the basis of property for as long as they are important in figuring the basis of the original or replacement property.

Keep copies of tax returns you have filed and the tax return package as part of your records. They may be helpful in amending filed returns or preparing future ones.

If you need a copy of a prior year tax return, you can obtain it from the IRS. Use Form 4506, *Request for Copy of Tax Form.* A $4.25 charge for a copy of a return must be paid with Form 4506.

Contact your local IRS office if you need a transcript of your tax account. You should have available your name, social security number or employer identification number (if applicable), tax period, and form number. You will receive the following information free of charge:

- Type of return filed.
- Filing status.
- Tax shown on return.
- Adjusted gross income.
- Taxable income.
- Self-employment tax.
- Number of exemptions.

For more information on recordkeeping, get Publication 552, *Recordkeeping for Individuals.*

2. Filing Status

Your filing status is used in determining your filing requirements, standard deduction, and correct tax. It is also important in determining whether you are eligible to claim certain other deductions and credits. See *Who Must File* in Chapter 1 for the filing requirements. See Chapter 21 for information on the standard deduction. Your correct tax is determined by using the Tax Rate Schedule or the column in the Tax Table that applies to your filing status. There are five filing statuses:

- Single
- Married filing jointly
- Married filing separately
- Head of household
- Qualifying widow or widower

You must indicate your filing status by checking the appropriate box on lines 1 through 5 of Form 1040 or Form 1040A. There are no boxes for filing status on Form 1040EZ because your filing status must be single (under 65 and not blind) to file that form.

Single taxpayers. You must file as single if, on the last day of your tax year, you are unmarried or separated from your spouse either by divorce or separate maintenance decree and you do not qualify for another filing status.

State law governs whether you are married, divorced, or legally separated under a decree of separate maintenance.

Married taxpayers. You and your spouse may be able to file a joint return, or you may file separate returns.

Head of household or qualifying widow or widower. If you are single, separated, divorced, or widowed, you may be able to file as a head of household. If you are a qualifying widow or widower with a dependent child, you may be able to use the joint tax rates.

Single

Your filing status is ***single*** if you are unmarried or separated from your spouse either by a divorce or separate maintenance decree, and do not qualify for another filing status. However, if you were considered married for part of the year and lived in a community property state (listed under *Married Filing Separately),* special rules may apply in determining your income and expenses. See Publication 555, *Federal Tax Information on Community Property,* for more information.

You may file Form 1040EZ (if you have no dependents, are under 65 and not blind), Form 1040A, or Form 1040. If you file Form 1040A or Form 1040, show your filing status by checking the box on line 1. Use the *Single* column of the Tax Table, or *Schedule X* of the Tax Rate Schedules, to figure your tax.

If you file as single, you do not qualify for the earned income credit.

Married Filing Jointly

You may choose ***married filing jointly*** as your filing status if you are married and both you and your spouse agree to file a joint return. On a joint return, you report your combined income and deduct your combined allowable expenses.

If you and your spouse decide to file a joint return, your tax may be lower than the other filing statuses, your standard deduction (if you do not itemize deductions) may be higher, and you may qualify for tax benefits that do not apply to other filing statuses. You may file a joint return even if one of you had no income or deductions. If you and your spouse each have income, you may want to figure your tax both on a joint return and on separate returns (using the filing status of married filing separately) to see which method gives you the lower tax.

If you file as married filing jointly, you may use Form 1040A or Form 1040. You select your filing status by checking the box on line 2 of either form. You figure your tax by using the *Married filing jointly* column of the Tax Table, or *Schedule Y-1* of the Tax Rate Schedules.

Married Taxpayers

You are considered married for the whole year if on the last day of your tax year you are either:

1) Married and living together as husband and wife,
2) Living together in a ***common law marriage*** that is recognized in the state where you now live or in the state where the common law marriage began,
3) Married and living apart, but not legally separated under a decree of divorce or separate maintenance, or
4) Separated under an interlocutory (not final) decree of divorce. For purposes of filing a joint return, you are not considered divorced.

If your spouse died during the year, you are considered married for the whole year.

If you did not remarry before the end of the tax year, you may file a joint return for yourself and your deceased spouse. See *The Final Return* in Chapter 4. You also may be entitled, for the next 2 years, to the special benefits for qualifying widows and widowers, described later.

If you remarried before the end of the tax year, you may file a joint return with your new spouse. Your deceased spouse's filing status is married filing separately for that year.

Married persons living apart. Even though you are not divorced or legally separated, if you live apart from your spouse and meet certain tests, you may be considered ***unmarried,*** and may file as head of household instead of as married filing separately. See *Head of Household,* later. If you qualify to file as head of household, your standard deduction will be higher, your tax may be lower, and you may be able to claim the earned income credit. See *Earned Income Credit* in Chapter 35.

If you are divorced under a final decree by the last day of the year, you are considered single for the whole year.

Exception. If you obtain a divorce in one year for the sole purpose of filing tax returns as unmarried individuals, and at the time of divorce you intended to and did remarry each other in the next tax year, you and your spouse must file as married individuals.

If you obtain a court decree of annulment, which holds that no valid marriage ever existed, you must file as single or head of household, whichever applies, for that tax year. You also must file amended returns claiming single or head of household status for all tax years affected by the annulment that are not closed by the statute of limitations for filing a tax return. The statute of limitations generally does not expire until 3 years after your original return was filed. For information on when and how to file an amended return, see *Amended Returns and Claims for Refund* in Chapter 1.

Filing a Joint Return

Both you and your spouse must include all your income, exemptions, and deductions on your joint return.

Both of you must use the same accounting period, but you may use different accounting methods. See *Accounting Periods and Methods* in Chapter 1.

Both of you may be held responsible, jointly and individually, for the tax and any interest or penalty due on your joint return. One spouse may be held responsible for all the tax due even though all the income was earned by the other spouse.

Exception. You may not have to pay the tax, interest, and penalties on a joint return if you establish that you did not know, and had no reason to know, that there was a substantial understatement of tax that resulted because your spouse:

1) Omitted a gross income item, or
2) Claimed a deduction, credit, or property basis in an amount for which there is no basis in fact or law.

When the facts and circumstances are considered, it also must be inequitable to hold you liable for the tax due. One factor is whether you significantly benefited, directly or indirectly, from your spouse's actions. Normal support is not a significant benefit.

This exception applies only if your spouse's action resulted in an understatement of tax of more than $500. To the extent the understatement is attributable to claiming an incorrect deduction, credit, or property basis, this exception is available only if your liability for tax, interest, and penalties is more than 10% of your adjusted gross income for the most recent tax year before the deficiency notice was mailed, if that income was $20,000 or less (25% if your adjusted gross income is more than $20,000). If you remarried before the end of that most recent year, include the income of your new spouse to see if the exception applies to you.

For purposes of this exception, community property rules do not apply to items of gross income (other than gross income from property).

Divorced taxpayer. You may still be held jointly and individually responsible for any tax, interest, and penalties due on a joint return filed before your divorce. This responsibility applies even if your divorce decree states that your former spouse will be responsible for any amounts due on previously filed joint returns.

Signing a joint return. For a return to be considered a joint return, both husband and wife must sign the return. If your spouse died before signing the return, see *Signing the return* in Chapter 4.

If your spouse is away from home, you should prepare the return, sign it, and send it to your spouse to sign so that it can be filed on time.

If your spouse cannot sign because of disease or injury and tells you to sign, you may sign your spouse's name in the proper space on the return followed by the words "By (your name), Husband (or Wife)." Be sure to also sign in the space provided for your signature. Attach a dated statement, signed by you, to the return. The statement should include the name of the return you are filing, the tax year, the reason your spouse cannot sign, and that your spouse has agreed to your signing for him or her.

If you are the guardian of your spouse who is mentally incompetent, you may sign the return for your spouse as guardian.

If your spouse cannot sign the joint return for any other reason, you may sign for your spouse only if you are given a valid power of attorney (a legal document giving you permission to act for your spouse). Attach the power of attorney to your tax return. You may use Form 2848, *Power of Attorney and Declaration of Representative.*

Nonresident alien and dual-status alien. A joint return cannot be made if either spouse is a nonresident alien at any time during the tax year. However, if at the end of the year one spouse was a nonresident alien or dual-status alien married to a U.S. citizen or resident, both spouses may choose to file a joint return. If you do file a joint return, you and your spouse must agree to be taxed as U.S. citizens or residents for the entire tax year. See *Nonresident Spouse Treated as a Resident* in Chapter 1 of Publication 519, *U.S. Tax Guide for Aliens.*

Married Filing Separately

You may choose ***married filing separately*** as your filing status if you are married. This method may benefit you if you want to be responsible only for your own tax or if this method results in less tax than a joint return. You may be required to use this filing status if you and your spouse do not agree to file a joint return.

Unless you are required to file separately, you may want to figure your tax both ways (on a joint return and on separate returns) to make sure you are using the method that results in lower combined tax. However, you generally will pay more combined tax on separate returns than you would on a joint return because the tax rate is higher for married persons filing separately.

If you file a separate return, report only your income, exemptions (you may not split an exemption), credits, and deductions on your individual return. You may file a separate return and claim an exemption for your spouse, if your spouse had no gross income and was not a dependent of another person. However, if your spouse had any gross income, or was the dependent of someone else, you may not claim an exemption for him or her on your separate return.

If you file as married filing separately, you may use Form 1040A or Form 1040. Select your filing status by checking the box on line 3 of either form. You must also write your spouse's social security number and full name in the spaces provided. Figure your tax by using the *Married filing separately* column of the Tax Table or *Schedule Y-2* of the Tax Rate Schedules.

Separate Returns

Special rules apply when filing a separate return.

Deductions on separate returns. If you and your spouse file separate returns and one of you itemizes deductions, the other should also itemize deductions, because he or she cannot take the standard deduction. However, see *Married persons living apart,* earlier.

Community property states. If you live in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin and file separately, your income may be separate income or community income for income tax purposes. See Publication 555, *Federal Tax Information on Community Property.*

If you file a separate return:

1) You cannot take the credit for child and dependent care expenses in most instances.
2) You cannot take the earned income credit.
3) If you lived with your spouse at any time in 1990:
   a) You cannot take the credit for the elderly or the disabled.
   b) You may have to include in income up to one-half of any social security benefits (including any equivalent railroad retirement benefits) you received in 1990.

Individual Retirement Arrangements (IRAs). If you make contributions to your Individual Retirement Account, your IRA deduction is subject to a phaseout rule if either you or your spouse was covered by an employer retirement plan, you and your spouse file separate returns, and you lived together during the year. See *Deductible Contributions* in Chapter 19.

Passive activity losses. You may generally offset a loss from a rental real estate activity of up to $25,000 against your nonpassive income if you actively participate in the activity. However, if you are married filing a separate return and you lived together at any time during the year, you may not claim this offset for a loss from a rental real estate activity. If you are married filing a separate return and you live apart from your spouse at all times during the year, your maximum offset for rental real estate activities is $12,500. See *Limits on Rental Losses* in Chapter 10.

Joint Return After Separate Returns

You may change your filing status by filing an amended return using Form 1040X, *Amended U.S. Individual Income Tax Return.*

If you or your spouse (or each of you) files a separate return, you may change to a joint return any time within 3 years from the due date of the separate return or returns. This does not include any extensions. A separate return includes a return filed by you or your spouse claiming married filing separately, single, or head of household filing status. If the amount paid on your separate returns is less than the total tax shown on the joint return, you must pay the additional tax due on the joint return when you file it.

Separate Returns After Joint Return

Once you file a joint return, you may not choose to file separate returns for that year after the due date of the return.

Head of Household

Your filing status is ***head of household*** if you are unmarried or considered unmarried on the last day of the year and pay more than half the cost of keeping up a home for you and a dependent. The rules to qualify for head of household are explained below.

If you qualify to file as head of household, your tax rate will be lower than the rates for single or married filing separately, and you may qualify for the earned income credit and the child care credit. You also receive a higher standard deduction than if you file as single or married filing separately. (You can only claim the standard deduction if you do not itemize deductions.)

Note. If you were considered married for part of the year and lived in a community property state (listed under *Married Filing Separately*), special rules may apply in determining your income and expenses. See Publication 555 for more information.

If you file as head of household, you may use either Form 1040A or Form 1040. Indicate your choice of this filing status by checking the box on line 4 of either form. You figure your tax by using the *Head of a household* column of the Tax Table or *Schedule Z* of the Tax Rate Schedules.

You may be eligible to file as head of household if you were unmarried or were considered unmarried on the last day of the year. You must have paid more than half the cost of keeping up a home that was the main home for more than half the year for you and any of the following:

1) Your child, grandchild, stepchild, or adopted child who is:
   a) Single. This child does not have to be your dependent.
   b) Married. This child must qualify as your dependent unless you state in writing to the noncustodial parent that he or she may claim an exemption for the dependent, or the noncustodial parent provides at least $600 support for the dependent and claims an exemption for the dependent under a pre-1985 divorce or separation agreement.
2) Any relative listed below whom you can claim as a dependent. However, if your dependent parent does not live with you, a special rule applies. See *Father or mother*, later.

Parent	Brother-in-law
Grandparent	Sister-in-law
Brother	Son-in-law
Sister	Daughter-in-law, or
Stepbrother	If related by blood:
Stepsister	Uncle
Stepmother	Aunt
Stepfather	Nephew
Mother-in-law	Niece
Father-in-law	

You are related by blood to an uncle or aunt if he or she is the brother or sister of your father or mother.

You are related by blood to a nephew or niece if he or she is the child of your brother or sister.

Dependents. If the person you support is required to be your dependent, you do not qualify as a head of household if you can only claim the dependent under a multiple support agreement. See *Multiple Support Agreement* in Chapter 3.

Foster child. You qualify as head of household if you meet the rules above and you can claim your foster child as a dependent.

Father or mother. You may be eligible to file as head of household even if your dependent parent does not live with you. You must pay more than half the cost of keeping up a home that was the main home for the ***entire*** year for your mother or father. You are keeping up a main home for your dependent father or mother if you pay more than half the cost of keeping your parent in a rest home or home for the elderly.

You are considered unmarried on the last day of the tax year if you meet all of the following tests.

1) You file a separate return.
2) You paid more than half the cost of keeping up your home for the tax year.
3) Your spouse did not live in your home during the last 6 months of the tax year.
4) Your home was, for more than half the year, the main home of your child, stepchild, or adopted child whom you can claim as a dependent. However, you can still meet this test if you cannot claim your child as a dependent only because:
   a) You state in writing to the noncustodial parent that he or she may claim an exemption for the child, or
   b) The noncustodial parent provides at least $600 support for the dependent and claims an exemption for the dependent under a pre-1985 divorce or separation agreement.

If the qualifying person is your child but not your dependent, enter that child's name in the space provided on line 4 of Form 1040 or Form 1040A.

Temporary absences. You are considered to occupy the same household despite the temporary absence due to special circumstances of either yourself or the other person. Temporary absences due to special circumstances include those due to illness, education, business, vacation, and military service. It must be reasonable to assume that you or the other person will return to the household after the temporary absence, and you must continue to maintain a household in anticipation of the return.

Death or birth. If the dependent who qualifies you to use head of household filing status is born or dies during the year, you still may be able to claim that filing status. You must have provided more than half of the cost of keeping up a home, which was the dependent's main home for more than half the year, or, if less, the period during which your dependent lived.

Example. You are unmarried. Your mother lived in an apartment by herself. She died on September 2, 1990. The cost of the upkeep of her apartment for the year until her death was $6,000. You paid $4,000 and your brother paid $2,000. Your brother made no other payments towards your mother's support. Your mother had no income. Since you paid more than half the cost of keeping up the apartment for your mother from January 1, 1990, until her death, and she qualifies as your dependent, you may file as a head of household.

Nonresident alien spouse. You are considered unmarried for head of household purposes if your spouse was a nonresident alien at any time during the year, and you do not choose to treat your nonresident spouse as a resident alien. Your spouse is not considered your relative. You must have another qualifying relative and meet the other tests to be eligible to file as a head of household. However, you are considered married if you have chosen to treat your spouse as a resident alien. See *Nonresident Spouse Treated as a Resident* in Chapter 1 of Publication 519.

Dual-status and nonresident alien taxpayers may not claim head of household status.

Keeping Up a Home

You are keeping up a home only if you pay ***more than half*** of the cost of its upkeep. You may determine whether you paid more than half of the cost of keeping up a home by using the following worksheet.

Cost of Maintaining a Household

	Amount You Paid	Total Cost
Property taxes	$_____	$_____
Mortgage interest expense	_____	_____
Rent	_____	_____
Utility charges	_____	_____
Upkeep and repairs	_____	_____
Property insurance	_____	_____
Food consumed on the premises	_____	_____
Other household expenses	_____	_____
Totals	$_____	$_____
Minus total amount you paid		($_____)
Amount others paid		$_____

If you paid more than others paid, you meet the requirement of maintaining a household for head of household filing status.

Include such costs as rent, mortgage interest, taxes, insurance on the home, repairs, utilities, and food eaten in the home.

Do not include the cost of clothing, education, medical treatment, vacations, life insurance, transportation, the rental value of a home you own, or the value of your services or those of a member of your household.

Include or exclude these expenses only to figure whether you are keeping up a home. Do not claim them as deductions on your return unless they are otherwise deductible. See *Support Test* in Chapter 3 for expenses you can use to figure if a person qualifies as your dependent.

State AFDC (Aid to Families with Dependent Children) payments you use to keep up your home do not count as amounts you paid. Include these amounts in the total cost of keeping up your home to figure if you paid more than half.

Qualifying Widows and Widowers

If your spouse died in 1990, you may use married filing jointly as your filing status for 1990 if you would otherwise qualify. See *Married Filing Jointly*, earlier.

If your spouse died in 1988 or 1989, and you have not remarried, you may be able to use ***Qualifying widow(er)*** as your filing status for 1990.

This filing status entitles you to use joint return tax rates, the highest standard deduction amount, and other deductions and tax credits. (You can only claim the standard deduction if you do not itemize deductions.) This status does not authorize you to file a joint return.

Indicate your filing status by checking the box on line 5 of either Form 1040A or Form 1040 (you may not file Form 1040EZ). Write the year your spouse died in the space provided on line 5 of Form 1040A or Form 1040. You figure your tax by using the *Married filing jointly* column of the Tax Table or *Schedule Y–1* of the Tax Rate Schedules.

You may be eligible to file as a Qualifying widow(er) if you meet all of the following tests.

- You were entitled to file a joint return with your spouse for the year your spouse died (it does not matter whether you actually filed a joint return).
- You did not remarry before the end of the tax year.
- You have a child, stepchild, adopted child, or foster child who qualifies as your dependent for the year.
- You paid more than half the cost of keeping up your home, which is the main home of that child for the entire year except for temporary absences. See *Temporary absences* and *Keeping Up a Home*, discussed earlier under *Head of Household*.

Example. John Reed's wife died in 1988. John has not remarried. He has continued during 1989 and 1990 to keep up a home for himself and his dependent child. For 1988 he was entitled to file a joint return for himself and his deceased wife. For 1989 and 1990 he may file as qualifying widower because he is a widower with a dependent child. After 1990 he may file as head of household if he qualifies.

Death or birth. If the dependent who qualifies you to use qualifying widow(er) filing status is born or dies during the year, you still may be able to claim that filing status. You must have provided more than half of the cost of keeping up a home, which was the dependent's main home, during the entire part of the year he or she was alive.

3. Personal Exemptions and Dependents

Important Change for 1990

Exemptions. The amount you may deduct as an exemption is increased from $2,000 in 1989 to $2,050 in 1990.

Important Reminder

Social security numbers for dependents. If you claim a dependent on a tax return, you have to list the dependent's social security number if he or she is age ***two or older***.

Exemptions

Exemptions reduce your taxable income. Each exemption you claim in 1990 is worth $2,050. If you are entitled to two exemptions for 1990, you would deduct $4,100 ($2,050 × 2). The amount of the exemption is adjusted annually for inflation.

There are two types of exemptions: personal exemptions and dependency exemptions. While these are both worth the same amount, different rules, discussed later, apply to each type.

You usually may claim exemptions for yourself, your spouse, and each person you can claim as a dependent. If you are entitled to claim an exemption for a dependent (such as your child), that dependent cannot claim a personal exemption on his or her own tax return.

You may lose the benefit of part or all of your exemptions if you have a high taxable income. If your taxable income is more than $97,620, see *Phaseout of Exemptions*, later.

How to claim exemptions. How you claim an exemption on your tax return depends on which form you file.

If you file Form 1040EZ because you are single, you are allowed an exemption for yourself unless someone else can claim your exemption. The exemption amount is combined with the standard deduction and entered on line 4.

If you file Form 1040A, complete lines 6a through 6e. Follow the Form 1040A instructions. The total number of exemptions you can claim is the total in the box on line 6e. Also complete line 21 by multiplying the number in the box on line 6e by $2,050.

If you file Form 1040, complete lines 6a through 6e. Follow the Form 1040 instructions. On line 36, multiply the total exemptions shown in the box on line 6e by $2,050 and enter the result.

Personal Exemptions

You are generally allowed one exemption for yourself, and if you are married, one exemption for your spouse. These are called personal exemptions.

Your Own Exemption

You may take one exemption for yourself unless you can be claimed as a dependent by another taxpayer.

Single persons. If another taxpayer is entitled to claim you as a dependent, you may not take an exemption for yourself. This is true even if the other taxpayer does not actually claim your exemption.

Married persons. If you file a joint return, you may take your own exemption. If you file a separate return, you may take your own exemption only if another taxpayer is not entitled to claim you as a dependent.

Your Spouse's Exemption

Your spouse is never considered your dependent. You are permitted one exemption for your spouse only because you are married.

Joint return. If your spouse had any gross income, as defined in Chapter 1, you may take your spouse's exemption only if you and your spouse file a joint return.

Separate return. If you file a separate return, you may claim the exemption for your spouse only if your spouse had ***no gross income*** and was not the dependent of another taxpayer. This is true even if the other taxpayer does not actually claim your spouse's exemption. This is also true if your spouse is a nonresident alien.

If your spouse died during the year, you may generally claim your spouse's exemption under the rules just explained above.

If you remarried during the year, you may not take an exemption for your deceased spouse.

If you are a surviving spouse without gross income and you remarry, you may be claimed as an exemption on both the final separate return of your deceased spouse and the separate return of your new spouse whom you married in the same year. If you file a joint return with your new spouse, you may be claimed as an exemption only on that return.

If you obtain a final decree of divorce or separate maintenance by the end of the year, you may not take your former spouse's exemption. This rule applies even if you provided all of your former spouse's support.

Exemptions for Dependents

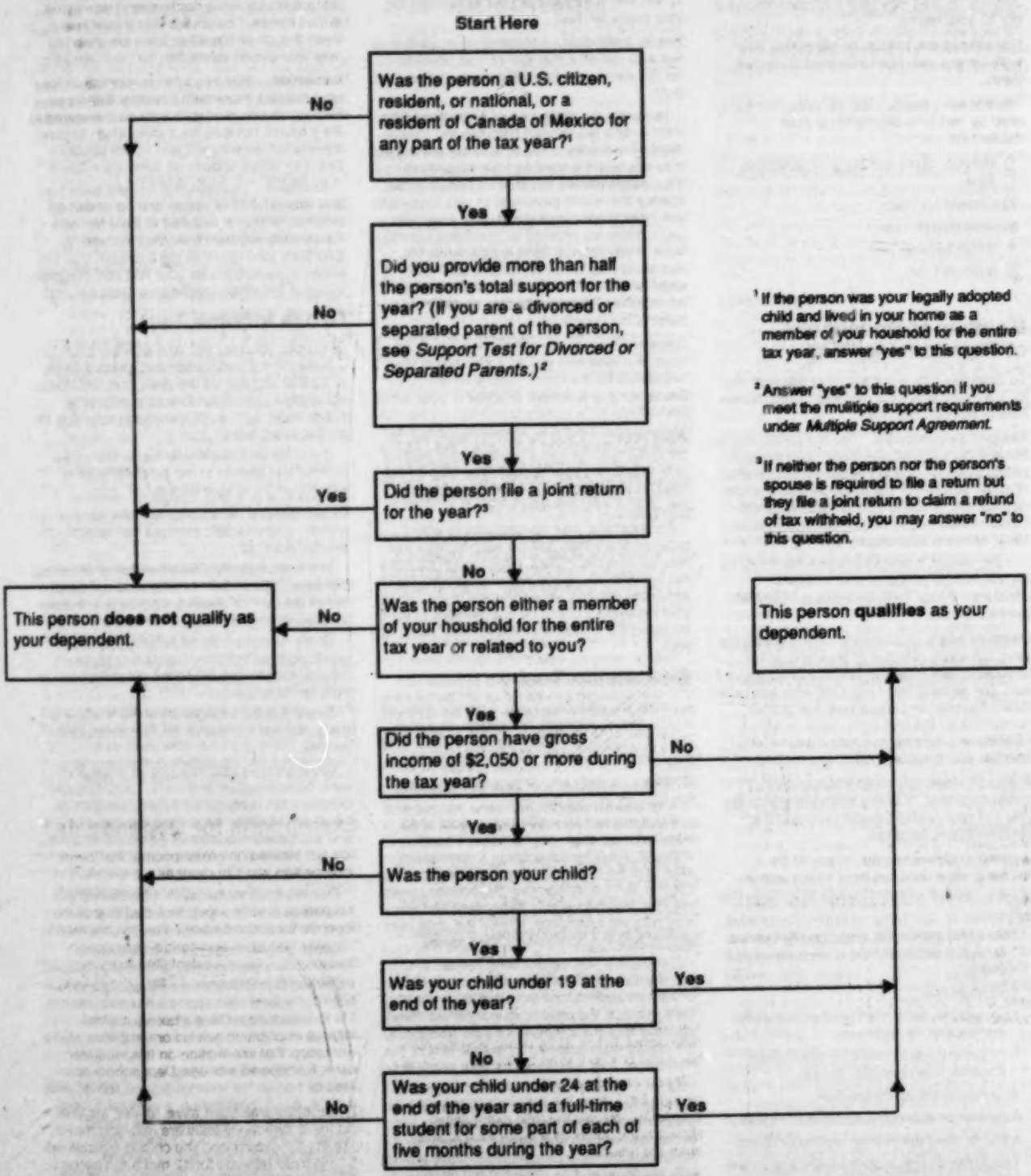
You are allowed one exemption of $2,050 for each person you can claim as a dependent in 1990. This is called a dependency exemption.

A person is your dependent if ***all five*** of the dependency tests, discussed below, are met. You may take an exemption for your dependent even if your dependent files a return. However, see *Joint Return Test*, later in this chapter.

If your dependent files a tax return, that dependent cannot claim his or her own exemption. For information on filing requirements for dependents, see *Dependents* in Chapter 1.

If your child was born alive during the year, and the dependency tests are met, you may take the full exemption. The child is considered to have lived with you for 12 months. This is true even if the child lived only for a moment. Whether your child was born alive depends on state or local law. There must be proof of a live birth shown by an official document, such as a birth certificate. You cannot claim an exemption for a stillborn child.

Who May Qualify as Your Dependent?


Start Here
Was the person a U.S. citizen, resident, or national, or a resident of Canada of Mexico for any part of the tax year?[1]
No
Yes
Did you provide more than half the person's total support for the year? (If you are a divorced or separated parent of the person, see *Support Test for Divorced or Separated Parents.*)[2]
No
Yes
Did the person file a joint return for the year?[3]
Yes
No
Was the person either a member of your household for the entire tax year or related to you?
No
This person **does not** qualify as your dependent.
Yes
Did the person have gross income of $2,050 or more during the tax year?
No
This person **qualifies** as your dependent.
Yes
Was the person your child?
No
Yes
Was your child under 19 at the end of the year?
Yes
No
Was your child under 24 at the end of the year and a full-time student for some part of each of five months during the year?
No
Yes

[1] If the person was your legally adopted child and lived in your home as a member of your household for the entire tax year, answer "yes" to this question.

[2] Answer "yes" to this question if you meet the multiple support requirements under *Multiple Support Agreement.*

[3] If neither the person nor the person's spouse is required to file a return but they file a joint return to claim a refund of tax withheld, you may answer "no" to this question.

If your dependent died during the year and otherwise qualified as your dependent, you may take his or her exemption. The dependent is considered to have lived with you for 12 months.

Example. Your dependent mother died on January 15. You may take a full exemption for her on your return.

Housekeepers, maids, or servants who work for you may not be claimed as dependents.

Dependency tests. The following five tests must be met for a person to be your dependent:

1) Member of Household or Relationship Test
2) Citizenship Test
3) Joint Return Test
4) Gross Income Test
5) Support Test

Member of Household or Relationship Test

To meet this test, a person must live with you for the entire year as a member of your household or be related to you.

Temporary absences. You are considered to occupy the same household despite the temporary absence due to special circumstances of either yourself or the other person. Temporary absences due to special circumstances include those due to illness, education, business, vacation, and military service.

If the person is placed in a nursing home for an unspecified period of time to receive constant medical care, the absence is considered temporary.

Death or birth. A person who died during the year, but was a member of your household until death, will meet the member of household test. The same is true for a child who was born during the year and was a member of your household for the rest of the year, or would have been a member except for any required hospital stay following birth.

A person does not meet the member of household test if at any time during your tax year the relationship between you and that person violates local law.

A person related to you in any of the following ways does not have to live with you or be a member of your household to meet this test.

- Your child, grandchild, great grandchild, etc. (a legally adopted child is considered your child),
- Your stepchild,
- Your brother, sister, half brother, half sister, stepbrother, or stepsister,
- Your parent, grandparent, or other direct ancestor, but not foster parent,
- Your stepfather or stepmother,
- A brother or sister of your father or mother,
- A son or daughter of your brother or sister,
- Your father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law.

Any of the above relationships that were established by marriage are not ended by death or divorce.

Adoption. Before legal adoption, a child is considered to be your child if he or she was placed with you for adoption by an authorized agency and was a member of your household. If the child was not placed with you by such an agency, the child will meet this test only if he or she was a member of your household for your entire tax year.

Foster individual. A foster child or adult must live with you as a member of your household for the entire year to qualify as your dependent.

However, if a state, one of its political subdivisions, or a tax-exempt child-placing agency makes payments to you as a foster parent, you may not take the child as your dependent. Your expenses are incurred on behalf of the agency that made payments to you. Expenses you incur in excess of nontaxable payments you receive are allowed as charitable contributions. If you receive taxable payments, your expenses may be deductible as business expenses. See *Foster-care providers* under *Income Not Taxed* in Chapter 13 and *Foster parents* in Chapter 25.

Cousin. Your cousin will meet this test only if he or she lives with you as a member of your household for the entire year. A cousin is a descendant of a brother or sister of your father or mother.

Joint return. If you file a joint return, you do not need to show that a dependent is related to both you and your spouse. You also do not need to show that a dependent is related to the spouse who provides support.

For example, your spouse's uncle who receives more than half his support from you may be your dependent, even though he does not live with you. If you and your spouse file ***separate returns***, your spouse's uncle can be your dependent only if he is a member of your household and lives with you for your entire tax year.

Citizenship Test

To meet the citizenship test, a person must be a U.S. citizen, resident, or national, or a resident of Canada or Mexico for some part of the calendar year in which your tax year begins.

Children usually are citizens or residents of the country of their parents.

If you were a U.S. citizen when your child was born, the child may be a U.S. citizen although the other parent was a nonresident alien and the child was born in a foreign country. If so, and the other dependency tests are met, the child is your dependent and you may take the exemption, even if the child lives abroad with the nonresident alien parent.

If you are a U.S. citizen living abroad who has legally adopted a child who is not a U.S. citizen or resident, and the other dependency tests are met, the child is your dependent and you may take the exemption if your home is the child's main home and the child is a member of your household for your entire tax year.

Foreign students brought to this country under a qualified international education exchange program and placed in American homes for a temporary period generally are not U.S. residents and do not meet the citizenship test. They may not be claimed as dependents. However, if you provided a home for a foreign student, you may be able to take a charitable contribution deduction. See *Student Living With You* in Chapter 25.

Joint Return Test

Even if the other dependency tests are met, you are not allowed an exemption for your dependent if he or she files a joint return.

Example. You supported your daughter for the entire year while her husband was in the armed forces. The couple files a joint return. Even though all the other tests are met, you may not take an exemption for your daughter.

Exception. You may take an exemption for your married dependent if neither the dependent nor the dependent's spouse is required to file a return, but they file a joint return to claim a refund of tax withheld and no tax liability exists for either spouse on separate returns.

Example. Your son and his wife each had less than $1,000 of wages and no unearned income. Neither is required to file a tax return. Taxes were withheld from their income, so they file a joint return to get a refund. You are allowed exemptions for your son and daughter-in-law, if the other dependency tests are met.

Gross Income Test

Generally, you may not take an exemption for a dependent if that person had gross income of $2,050 or more for the year. This test does not apply if the person is your child and is either under age 19, or a student under age 24, as discussed later.

If you file on a fiscal year basis, the gross income test applies to the calendar year in which your fiscal year begins.

Gross income is all income in the form of money, property, and services that is not exempt from tax.

In a manufacturing, merchandising, or mining business, gross income is the total net sales minus the cost of goods sold, plus any miscellaneous income from the business.

Gross receipts from rental property are gross income. You may not deduct taxes, repairs, etc., to determine the gross income from rental property.

Gross income includes a partner's share of the gross, not a share of the net, partnership income.

Gross income also includes all unemployment compensation and certain scholarships. Scholarships received by degree candidates, which are used for tuition and fees, and books and equipment required for particular courses, are not included in gross income. For more information, see Chapter 13.

Tax-exempt income, such as certain social security payments, is not included in gross income. See *Income Not Taxed* in Chapter 13.

Gross income does not include income received by a permanently and totally disabled individual at a sheltered workshop. The availability of medical care must be the main reason the individual is at the workshop, and the income must come solely from activities at the workshop that are incident to this medical care. A sheltered workshop is a school operated by certain tax-exempt organizations, or by a state, a U.S. possession, a political subdivision of a state or possession, the United States, or the District of Columbia, that provides special instruction or training designed to alleviate the disability of the individual.

Your child is your son, stepson, daughter, stepdaughter, a legally adopted child, or a child who was placed with you by an authorized placement agency for your legal adoption. A

foster child who was a member of your household for your entire tax year is also considered your child. See *Foster individual*, earlier.

If your child is under 19 at the end of the year, the gross income test does not apply. Your child may have any amount of income and still be your dependent, if the other dependency tests are met.

Example. Marie Grey, 18, earned $2,400. Her father provided more than half her support. Marie may be claimed as a dependent because the gross income test does not apply and the other dependency tests were met.

If your child is a student, the gross income test does not apply if the child is under age 24 at the end of the calendar year. The other dependency tests must still be met.

To qualify as a student your child must be, during some part of each of 5 calendar months during the calendar year (not necessarily consecutive):

1) A full-time student at a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance, or
2) A student taking a full-time, on-farm training course. The course has to be given by a school or a state, county, or local government. The school must have a regular teaching staff, course of study, and regularly enrolled body of students in attendance.

A ***full-time student*** is one who is enrolled for the number of hours or courses the school considers to be full-time attendance.

The term "school" includes elementary schools, junior and senior high schools, colleges, universities, and technical, trade, and mechanical schools. It does not include on-the-job training courses, correspondence schools, and night schools.

Example. James Clay, 22, attends college as a full-time student. During the summer, James earned $2,700, which he spent for his support. His parents provided more than $2,700 toward his support and the other dependency tests were met. On their return, they may claim the exemption for James as a dependent.

Vocational high school students who work on "co-op" jobs in private industry as a part of the school's prescribed course of classroom and practical training are considered full-time students.

Night school. Your child is not a full-time student while attending school only at night. However, full-time attendance at a school may include some attendance at night as part of a full-time course of study.

Correspondence and employee training courses. Your child does not qualify as a full-time student by taking correspondence courses, employee training courses, or similar programs.

Support Test

You must provide more than half of a person's total support during the calendar year to meet the support test. You figure whether you have provided more than half by comparing the amount you contributed to the person's support with the entire amount of support the person received from all sources. This amount includes the person's own funds used for support. You may not include in your contribution any part of your child's support that is paid for by the child with the child's own wages, even if you pay the wages. See *Total Support*, later. For exceptions to the support test, see *Multiple Support Agreement* and *Support Test for Divorced or Separated Parents*, later.

A person's own funds are not support unless they are actually spent for support.

Example. Your mother received $2,400 in social security benefits and $300 in interest. She paid $2,000 for lodging, $400 for recreation, and $300 for life insurance premiums.

Even though your mother received a total of $2,700, she spent only $2,400 for her own support. Life insurance premiums are not support items. If you spent more than $2,400 for her support and no other support was received, you have provided more than half her support.

The total cost, not the period of time you provide the support, determines whether you provide more than half of the support.

The year you provide the support is the year you pay for it, even if you do so with borrowed money that you repay in a later year.

If you use a fiscal year to report your income, you must provide more than half of the dependent's support for the calendar year in which your fiscal year begins.

Armed forces dependency allotments. Any dependency allotments withheld from your military pay are considered provided by you in figuring whether you provide more than half of the support. If your allotment is used to support persons other than those you name, you may take the exemptions for them, if they otherwise qualify as dependents.

Example. You are in the armed forces. You authorize an allotment for your widowed mother which she uses for the support of herself and your sister. If it provides more than half of their support, you may take an exemption for each of them, even though you authorize the allotment only for your mother.

Tax-exempt military quarters allowances are treated the same way as dependency allotments in figuring support. Both the allotment of pay and the tax-exempt basic allowance for quarters are considered as provided by you for support.

Tax-exempt income. In figuring a person's total support, you must include tax-exempt income, savings, and borrowed amounts used to support that person. Tax-exempt income includes certain social security benefits, welfare benefits, nontaxable life insurance proceeds, armed forces family allotments, nontaxable pensions, and tax-exempt interest.

Example 1. You provide $2,000 for your mother's support during the year. She has taxable income of $600, nontaxable social security benefit payments of $1,800, and tax-exempt interest of $200. She uses all these for her support. You may not claim your mother as a dependent because the $2,000 you provide is not more than half of her total support of $4,600.

Example 2. Your daughter takes out a student loan of $2,500 and uses it to pay her college tuition. She is personally responsible for the loan. You provide $2,000 toward her total support. You may not claim your daughter as a dependent because you provide less than half of her support.

Social security benefit payments. If a husband and wife each receive social security benefit payments that are paid by one check made out to both of them, half of the total paid is considered to be for the support of each spouse, unless they can show otherwise.

If a child receives social security benefits and uses them toward his or her own support, the payments are considered provided by the child.

State benefit payments (welfare, food stamps, housing, etc.) based on need are considered as support provided by the state, unless it is shown otherwise. For example, AFDC (Aid to Families with Dependent Children) is not support provided by the parent. It is support provided by the state.

Home for the aged. If you make a lump-sum advance payment to a home for the aged to take care of your relative for life and the payment is based on that person's life expectancy, the amount of your support each year is the lump-sum payment divided by the relative's life expectancy. Your support also includes any other amounts that you provided during the year.

Total Support

To figure if you provided more than half of the support of a person, you must first determine the total support provided for that person.

Total support includes amounts spent to provide food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities.

Generally, the amount of an item of support is the amount of the expense incurred in providing that item. Expenses that are not directly related to any one member of a household, such as the cost of food for the household, must be divided among members of the household. If the item is property or lodging, the amount of such item is its fair rental value.

Example. Your parents live with you, your spouse, and your two children in a house you rent. The fair rental value of their share of lodging is $2,000 a year. Your father receives a nontaxable pension of $4,200, which he spends equally for items of support such as clothing, transportation, and recreation, for your mother and himself. Your total food expense for the household is $6,000. Your heat and utility bills amount to $1,200. Your mother has hospital and medical expenses of $600, which you pay during the year. Figure your parents' total support as follows:

	Support provided	
	Father	Mother
Fair rental value of lodging	$1,000	$1,000
Pension spent for their support	2,100	2,100
Share of food (1/6 of $6,000)	1,000	1,000
Medical expenses for mother		600
Parents' total support	$4,100	$4,700

Since you provided different amounts to each parent, you must figure the dependency status of each parent separately. You provide $2,000 ($1,000 lodging + $1,000 food) of your father's total support of $4,100—less than half. You provide $2,600 to your mother ($1,000 lodging, $1,000 food, $600 medical)—more than half of her total support of $4,700. You may claim your mother as a dependent, but not your father. Heat and utilities are included in the fair rental value of the lodging, so these are not considered separately.

Lodging is the fair rental value of the room, apartment, or house in which the person lives. It includes a reasonable allowance for the use

of furniture and appliances, and for heat and other utilities. Fair rental value is used in place of rent or taxes, interest, depreciation, paint, insurance, utilities, cost of furniture and appliances, etc. In some cases, fair rental value may be equal to the rent paid.

The fair rental value is the amount you could reasonably expect to receive from a stranger for the same kind of lodging.

If you are considered to provide the total lodging, determine the fair rental value of the room the person uses, or a share of the fair rental value of the entire dwelling if the person has use of your entire home.

If you do not provide the total lodging, the total fair rental value must be divided depending on how much of the total lodging you provide. If you provide only a part and the person supplies the rest, the fair rental value must be divided between you according to the amount each of you provides.

Example. Your parents live rent-free in a house you own. It has a fair rental value of $5,400 a year furnished, which includes a fair rental value of $3,600 for the house and $1,800 for the furniture. This does not include heat and utilities. The house is completely furnished with furniture belonging to your parents. You pay $800 for their utility bills. Utilities are not usually included in rent for houses in the area where your parents live. Therefore, you consider the total fair rental value of the lodging to be $6,000 ($3,600 fair rental value of the unfurnished house, $600 cost of utilities, and $1,800 allowance for furnishings provided by your parents) of which you are considered to provide $4,200 ($3,600 + $600).

Person living in his or her own home. The total fair rental value of a person's home is considered support contributed by that person.

If you help to keep up the home by paying interest on the mortgage, real estate taxes, fire insurance premiums, ordinary repairs, or other items directly related to the home or give someone cash to pay those expenses, reduce the total fair rental value of the home by those amounts in figuring that person's own contribution.

Example. You provide $3,000 cash for your father's support during the year. He lives in his own home, which has a fair rental value of $3,600 a year. He uses $600 of the money you give him to help pay his real estate taxes. Your father's contribution for his own lodging is $2,800 ($3,600 − $800 for taxes).

If you live with a person rent-free in his or her home, you must reduce the amount you provide for support by the fair rental value of lodging he or she provides you.

Property provided as support is measured by its fair market value.

Capital expenses. Capital items, such as furniture, appliances, and cars, that are bought for a person during the year, may be included in total support under certain circumstances.

The following examples show when a capital item is or is not support.

Example 1. You buy a $200 power lawn mower for your 13-year-old child. The child is given the duty of keeping the lawn trimmed. Because a lawn mower is ordinarily an item that benefits all members of the household, you cannot include the cost of the lawn mower in the support of your child.

Example 2. You buy a $150 television set as a birthday present for your 12-year-old child. The television set is placed in your child's bedroom. You include the cost of the television set in the support of your child.

Example 3. You pay $5,000 for a car and register it in your name. You and your 17-year-old daughter use the car equally. Because you own the car and do not give it to your daughter but merely let her use it, you cannot include the cost of the car in your daughter's total support. However, you can include in your daughter's support your out-of-pocket expenses of operating the car for her benefit.

Example 4. Your 17-year-old son, using personal funds, buys a car for $4,500. You provide all the rest of your son's support—$4,000. Since the car is bought and owned by your son, the car's fair market value ($4,500) must be included in his support. The $4,000 support you provide is less than half of his total support of $8,500. You cannot claim your son as a dependent.

Medical insurance premiums include premiums you pay for supplementary Medicare coverage. These are included in the total support you provide.

Medical insurance benefits, including basic and supplementary Medicare benefits, are not part of support.

Amounts veterans receive under the GI Bill for tuition payments and allowances while they attend school are included in total support.

Example. During the year, your son receives $2,200 from the government under the GI Bill. He uses this amount for his education. You provide the rest of his support—$2,000. Because GI benefits are included in total support, your son is not your dependent.

Other items may be considered as support depending on the facts in each case. For example, if you pay someone to provide child or disabled dependent care, you may include these payments as support, even if you claim a credit for them. For information on the credit, see Chapter 33.

Do Not Include in Total Support

The following items are not included in total support:

- Federal, state, and local income taxes paid by persons from their own income.
- Social security taxes paid by persons from their own income.
- Life insurance premiums.
- Funeral expenses.
- Scholarships received by your child if your child is a full-time student. (If a child is committed to a state training school because of antisocial behavior, the value of the room, board, and education provided is not a scholarship. It must be included in support.)
- Survivors' and Dependents' Educational Assistance payments used for support of the child who receives them.

Multiple Support Agreement

Sometimes no one provides more than half of the support of a person. Instead, two or more persons, each of whom would be able to take the exemption but for the support test, together provide more than half the person's support.

When this happens, you may agree that any one of you who individually provides more than 10% of the person's support, but **only one,** may claim an exemption for that person. Each of the others must sign a written statement agreeing not to claim the exemption for that year. The statements must be filed with the income tax return of the person who claims the exemption. **Form 2120,** *Multiple Support Declaration,* is used for this purpose.

Example 1. You, your sister, and your two brothers provide the entire support of your mother for the year. You provide 45%, your sister 35%, and your two brothers each provide 10%. Either you or your sister may claim an exemption for your mother. The other must sign a Form 2120 or a written statement agreeing not to take an exemption for her. Because neither brother provides more than 10% of the support, neither can take the exemption. They do not have to sign a Form 2120 or the statement.

Example 2. You and your brother each provide 20% of your mother's support for the year. The remaining 60% of her support is provided equally by two persons who are not related to her. She does not live with them. Because more than half of her support is provided by persons who cannot claim her as a dependent, no one may claim the exemption.

Example 3. Your father lives with you and receives 25% of his support from social security, 40% from you, 24% from his brother, and 11% from a friend. Either you or your uncle may take the exemption for your father. A Form 2120 or a written statement from the person not claiming the exemption must be attached to the return of the one who takes the exemption.

Support Test for Divorced or Separated Parents

The support test for a child of divorced or separated parents is based on special rules that apply only if:

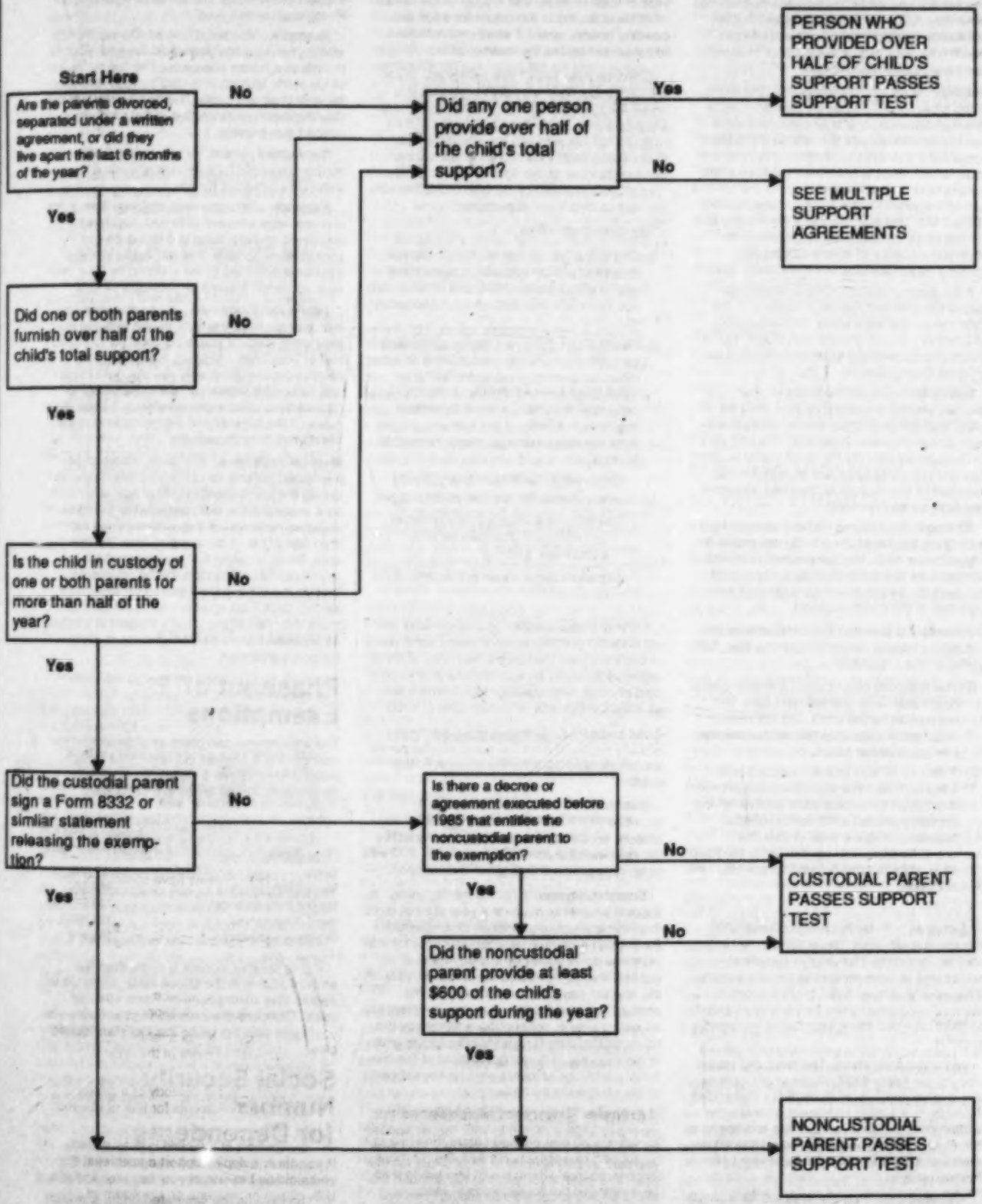
1) The parents are divorced or legally separated under a decree of divorce or separate maintenance, or separated under a written separation agreement, or lived apart at all times during the last 6 months of the calendar year, and
2) One or both parents provide more than half of the child's total support for the calendar year, and
3) One or both parents have custody of the child for more than half of the calendar year.

Child is defined earlier under the *Gross Income Test.*

Exceptions. This discussion does not apply in any of the following situations:

1) A third party, such as a relative or friend, provides half or more of the child's support,
2) The child is in the custody of a person other than the parents for half of the year or more,
3) The support of the child is determined under a multiple support agreement, as discussed earlier, or
4) The parents are separated under a written separation agreement, or are living apart, but they file a joint return for the tax year.

Support Test for Children of Divorced or Separated Parents


Start Here
Are the parents divorced, separated under a written agreement, or did they live apart the last 6 months of the year?
No
Yes
Did any one person provide over half of the child's total support?
Yes
PERSON WHO PROVIDED OVER HALF OF CHILD'S SUPPORT PASSES SUPPORT TEST
No
SEE MULTIPLE SUPPORT AGREEMENTS
Did one or both parents furnish over half of the child's total support?
No
Yes
Is the child in custody of one or both parents for more than half of the year?
No
Yes
Did the custodial parent sign a Form 8332 or simliar statement releasing the exemption?
No
Yes
Is there a decree or agreement executed before 1985 that entitles the noncustodial parent to the exemption?
No
Yes
CUSTODIAL PARENT PASSES SUPPORT TEST
Did the noncustodial parent provide at least $600 of the child's support during the year?
No
Yes
NONCUSTODIAL PARENT PASSES SUPPORT TEST

Custodial parent. The parent who has custody of the child for the greater part of the year is generally treated as the parent who provides more than half of the child's support. It does not matter whether that parent actually provided more than half of the support. However, see *Noncustodial parent*, later.

Custody is usually determined by the terms of the most recent decree of divorce or separate maintenance, or a later custody decree. If there is no decree, use the written separation agreement. If neither a decree nor agreement establishes custody, then the parent who has the physical custody of the child for the greater part of the year is considered to have custody of the child. This also applies if the validity of a decree or agreement awarding custody is uncertain because of legal proceedings pending on the last day of the calendar year.

If the parents are divorced or separated during the year and had joint custody of the child before the separation, the parent who has custody for the greater part of the rest of the year is considered to have custody of the child for the tax year.

Example 1. Under the terms of your divorce, you have custody of your child for 10 months of the year. Your former spouse has custody for the other 2 months. You and your former spouse provide the child's total support. You are considered to have provided more than half of the support of the child. However, see *Noncustodial parent.*

Example 2. Assume that in Example 1 your aunt gives $2,000 of the $3,100 necessary to support your child. Neither you nor your former spouse may claim the child as a dependent because the two of you did not provide more than half of the child's support.

Noncustodial parent. The noncustodial parent will be treated as providing more than half of the child's support if:

1) The custodial parent signs a written declaration that he or she will not claim the exemption for the child, and the noncustodial parent attaches this written declaration to his or her return, or
2) A decree or agreement executed before 1985 provides that the noncustodial parent is entitled to the exemption and he or she provides at least $600 for the child's support during the year, unless the pre-1985 decree or agreement is modified after 1984 to specify that this provision will not apply.

Example. Under the terms of your 1982 divorce decree, your former spouse has custody of your child. The decree specifically states that you are entitled to the exemption. You provide at least $600 in child support during the calendar year. You are considered to have provided more than half of the child's support.

Written declaration. The custodial parent should use **Form 8332,** *Release of Claim to Exemption for Child of Divorced or Separated Parents,* or a similar statement, to make the written declaration to release the exemption to the noncustodial parent. The noncustodial parent must attach the form or statement to his or her tax return.

The exemption may be released for a single year, for a number of specified years (for example, alternate years), or for all future years, as specified in the declaration. If the exemption is released for more than one year, the original release must be attached to the return of the noncustodial parent for the first year of such release, and a copy of the release must be attached to the return for each succeeding taxable year for which the noncustodial parent claims the exemption.

Children who didn't live with you. If you are claiming a child who didn't live with you under the rules for children of divorced or separated parents, enter the number of children who did not live with you (or who lived with their other parent for the greater part of the year) on the line to the right of line 6c labeled "No. of your children on 6c who didn't live with you due to divorce or separation."

Then you must either:

1) Check the box on line 6d if your divorce decree or written separation agreement was in effect before 1985 and it states that you can claim the child as your dependent, or
2) Attach Form 8332 or a similar statement to your return. If your divorce decree or separation agreement went into effect after 1984 and it unconditionally states that you can claim the child as your dependent, you may attach a copy of the following pages from the decree or agreement instead of Form 8332:

   Cover page (write the other parent's social security number on this page),

   The page that unconditionally states you can claim the child as your dependent, and

   Signature page showing the date of the agreement.

Enter the total number of children who did not live with you for reasons other than divorce or separation on the line labeled "No. of other dependents listed on 6c." Include your dependent children who were not U.S. citizens and who lived in Canada or Mexico during 1990.

Child support. All child support payments actually received from the noncustodial parent are considered used for the support of the child.

Example. The noncustodial parent provides $1,200 for the child's support. This amount is considered as support provided by the noncustodial parent even if the $1,200 was actually spent on things other than support.

Support payments for an earlier year. If support payments made this year are not more than the amount required of the noncustodial parent, the amount of support provided by that parent is not reduced by any payment of support that parent owed for an earlier year. If the support payments are more than the amount required for this year, any payment for an earlier year is not support provided by the noncustodial parent for either the earlier year or for this year. It is reimbursement to the custodial parent for amounts paid for the support of the children in an earlier year.

Example. Under your divorce decree, you must pay $400 a month to your former spouse for the support of your two children. Last year you paid $4,000 instead of $4,800 due for the year. This year, if you pay the full amount, the entire $4,800 is considered support that you provided. If you also pay any part of the $800 you owe from last year, that amount is not included as support provided by you in either year.

Support provided by a third party for a divorced or separated parent is not included as support provided by that parent. However, see *Remarried parent*, next.

Example. You are divorced. During the whole year, you and your child live with your mother in a house she owns. The fair rental value of the lodging provided by your mother for your child is $1,000. The home provided by your mother is not included in the amount of support you provide.

Remarried parent. If you remarry, the support provided by your new spouse is treated as provided by you.

Example. You have two children from a former marriage who live with you. You have remarried and are living in a home owned by your present spouse. The fair rental value of the home provided to the children by your present spouse is treated as provided by you.

Home jointly owned. If you and your former spouse have the right to use and live in the home, each of you is considered to provide half of your child's lodging. However, if the divorce decree gives only you the right to use and live in the home, you are considered to provide your child's entire lodging. It does not matter if the legal title to the home remains in the names of both parents.

Medical expenses. A child of divorced or separated parents or of parents who live apart during the last 6 months of the year is treated as a dependent of both parents for the medical expense deduction if the child receives more than half of his or her support from the parents. Thus, a parent can deduct medical expenses he or she paid for the child even though the other parent claims an exemption for the child. This special rule does not apply if more than half of the child's support is treated as received from a person under a multiple support agreement.

Phaseout of Exemptions

The amount you can claim as a deduction for exemptions is phased out once your taxable income goes above a certain level for your filing status. These levels are as follows:

Filing Status	Taxable income Subject to Exemption Phaseout
Single	$ 97,620
Married filing jointly	162,770
Married filing separately	123,570
Head of household	134,930
Qualifying widow(er)	162,770

If your taxable income is more than the amount shown in the above table, continue to deduct your exemptions on Form 1040 as usual. Compute the exemption phaseout when you figure your tax using the *Tax Rate Schedules.*

Social Security Number for Dependents

If you claim a dependent who is at least 2 years old by the end of your tax year and is a U.S. citizen or resident, or a resident of Canada or Mexico, you must list the dependent's social security number (SSN) on your Form 1040 or Form 1040A. If you do not list the dependent's SSN when required or if you

list an incorrect SSN, you may be subject to a penalty.

If a person whom you expect to claim as a dependent on your return does not have an SSN, either you or that person should apply for an SSN as soon as possible. The Internal Revenue Service does not issue social security numbers. Apply for an SSN by filing **Form SS-5** with the Social Security Administration. Information about applying for an SSN is available at your local Social Security Administration office.

Dependents living in Mexico or Canada. Taxpayers who claim dependents living in Mexico or Canada must have SSNs for these dependents.

A dependent living in **Mexico** may apply for an SSN at the U.S. Embassy in Mexico City or at a foreign service post in Ciudad Juarez, Guadalajara, Hermosillo, Matamoros, Mazatlan, Monterrey, Merida, or Tijuana. If you claim a dependent who lives in Mexico, enter "F" instead of a number in column (5) of line 6c of your Form 1040 or Form 1040A.

A dependent living in **Canada** may apply for an SSN at the American embassy in Ottawa or at a consulate. Those living near the U.S. border may also apply at a Social Security Administration office in a nearby American city. If you claim a dependent who lives in Canada, enter "F" instead of a number in column (5) of line 6c of your Form 1040 or Form 1040A.

4. Decedents

A final return must be filed on Form 1040, Form 1040A, or Form 1040EZ for a decedent (person who died), if the filing requirements discussed in Chapter 1 apply.

The final return is filed by a personal representative or survivor of the decedent. A personal representative of an estate can be an executor, administrator, or anyone in charge of the decedent's property. In general, an ***executor*** and an ***administrator*** perform the same duties and have the same responsibilities.

If the person who died did not meet any of the requirements for filing a return, but had tax withheld or paid estimated tax, a return should be filed to get a refund. A return should also be filed if the decedent was entitled to a refundable credit, such as the earned income credit. See Chapter 35 for additional refundable credits.

To claim any refund that is due, Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer,* must be filed and attached to the decedent's return. However, if you are a surviving spouse filing a joint return, or a personal representative filing Form 1040, Form 1040A, or Form 1040EZ for the decedent, you do not have to file Form 1310. If you are certified, or appointed by the court, you must attach to the decedent's return a copy of the court certificate showing your appointment.

See Publication 559, *Tax Information for Survivors, Executors, and Administrators,* for more information on the final income tax return of the decedent.

The Final Return

The personal representative or survivor must file the final return and any other return still due for the decedent. If you are acting in any fiduciary capacity (such as an executor or administrator), you must file a written notice with the Internal Revenue Service (IRS). Form 56, *Notice Concerning Fiduciary Relationship,* is available for this purpose. For more information, see Publication 559.

If the taxpayer died before filing a return for 1990, the taxpayer's spouse or personal representative may have to file and sign a return for the person who died. The person who files the return should write **"DECEASED"** the deceased's name, and the date of death across the top of the tax return. Include the same information on any **Form 1040X,** *Amended U.S. Individual Income Tax Return,* that is filed for a decedent.

Joint returns for decedent and surviving spouse. Generally, the personal representative and the surviving spouse may file a joint return for the decedent and the surviving spouse. However, the surviving spouse alone may file the joint return if no personal representative has been appointed before the due date for filing the return. This also applies if the decedent died after the close of the tax year and before the due date for filing a return.

A joint return with the deceased spouse may not be filed if the surviving spouse remarried before the end of the year in which the decedent died. The filing status of the deceased spouse is then "married filing separate return."

Change to separate return. A personal representative may change the joint return to a separate return. A personal representative appointed after a surviving spouse has filed a joint return with the decedent may cancel that return by filing a separate return for the decedent within one year from the due date of the return. The joint return will then become the survivor's separate return, and the tax will be refigured on the separate return.

When to file. The final return is due by the date the decedent's return would have been due had death not occurred.

The final return for the calendar year taxpayer is generally due by April 15 of the year following death, regardless of when during the year death occurred. However, when the due date falls on a Saturday, Sunday, or legal holiday, you may file on the next business day.

Death after a tax year. If the decedent died after the end of a tax year but before filing a return, a return must be filed for that year. A final return must also be filed for the year of death.

A request for prompt assessment of tax can shorten the time the IRS has in which to tax the estate of the decedent. A request may be filed by the personal representative of the decedent's estate after filing the decedent's final return or the estate's income tax return. The IRS usually has 3 years after the filing of a return or its due date, whichever is later, to charge any more tax that may be due. The request reduces the time for charging the tax to 18 months from the date the written request for prompt assessment was received. This may permit a quicker settlement of the tax responsibility of the estate and earlier distribution of the decedent's assets, such as money and property, to the beneficiaries.

Form 4810, *Request for Prompt Assessment Under Internal Revenue Code Section 6501(d),* may be used for making this request. The request must be filed separately from any other document. Send the request to the IRS office where the final return or the estate's income tax return was filed. If Form 4810 is not used, you must clearly indicate that it is a request for prompt assessment under Section 6501(d) of the Internal Revenue Code.

Signing the return. If an executor or administrator has been appointed, he or she must sign the return that is filed for the decedent. If a joint return is filed, the surviving spouse also must sign. If no executor or administrator has been appointed and a joint return is filed, the surviving spouse should sign the return and write in the signature area "Filing as surviving spouse." If no executor or administrator has been appointed and if there is no surviving spouse, the personal representative must file and sign the return as "personal representative."

Where to file. You can mail the decedent's final income tax return to the Internal Revenue Service Center designated for the area where you live. Hand carried returns, however, can be filed with any IRS office of the district director within your district.

Income Included in Final Return

If the decedent used the cash method of accounting, which most people use, the final return should show only the items of income, including self-employment income, that the decedent actually or constructively received before death.

If the decedent used the accrual method, the final return should show only those items of income, including self-employment income, that the decedent accrued before death. See Chapter 1 for discussion of accounting methods and constructive receipt.

Interest and dividend income (Form(s) 1099). Payers of interest, dividends, and certain other income report amounts on Forms 1099 using the name and identification number of the person to whom the account is payable. After a decedent's death, the Form(s) 1099 must reflect the name and identification number of the person to whom the amounts are payable. The personal representative must furnish this identification number to the payer. For example, if income, such as interest, is payable to the estate, the estate's name and identification number must be provided to the payer and used to report the interest on Form 1099–INT, *Statement for Recipients of Interest Income.* If the interest is payable to a surviving joint owner, the survivor's name and identification number must be provided to the payer and used to report the interest.

A Form 1099 reporting amounts earned prior to death should be received for the decedent. A separate Form 1099 showing the amounts earned after the date of death and payable to the estate or other recipient should also be received. A Form 1099–INT reporting interest payable to a decedent may include income that is properly reportable on the final income tax return of the decedent, as well as income earned after the date of death that is reportable by the estate or other recipient. If this occurs, you should ask the payer for corrected Form(s) 1099 that properly identify the recipient (by name and identification number) and

the accurate amounts. If that is not possible, include an explanation with the return, such as that described next under *How to report.*

How to report. If you have received Form(s) 1099–INT or Form(s) 1099–DIV for the decedent that include amounts belonging to the decedent and to another recipient (the decedent's estate or another beneficiary), prepare the decedent's final return as follows.

1) Report the total interest shown on Forms 1099–INT, on line 1, Part I of Schedule B (Form 1040).
2) Report the total dividend income shown on Forms 1099–DIV, on line 5, Part II of Schedule B (Form 1040).
3) On the appropriate schedule part (several lines above lines 2 and/or 6), enter a "subtotal" of the combined amounts of all of the interest or dividends reflected on Forms 1099, along with the interest or dividends from all other sources.
4) Below this subtotal, write "Nominee Distribution" and show the amount of any interest or dividends received that belongs to another recipient. Subtract it from the subtotal.
5) Report the net result on the proper line of the part of the income schedules being used (lines 2 and/or 6), and follow the directions shown for that line to carry the amount forward to the front of the return.

See Chapters 8 and 9 for more information about interest and dividend income.

Partnership income. If the decedent was a partner, the final return must include the decedent's distributive share of partnership income for the partnership's tax year that ends within or with the decedent's last tax year. If the partnership year is terminated with the death of a partner, see Publication 541, *Tax Information on Partnerships.*

The decedent's distributive share of partnership income from the date of the death to the end of the partnership tax year is not included in the final return. Partnership income earned during this time (including the date of death) is *Income in Respect of the Decedent,* discussed later in this chapter.

For information on how to compute the deceased partner's self-employment income, see Publication 541.

S corporation income. If the decedent was a shareholder in an S corporation, the final return must include the decedent's share of S corporation income, deductions, losses, etc., for the corporation's tax year that ends with or within the decedent's last tax year. The final return must also include the decedent's pro rata share of the S corporation's income, deductions, etc., for the period between the end of the S corporation's last tax year and the date of death.

The items of income, deduction, etc., for the part of the S corporation's tax year after the shareholder's death are taken into account by the estate or other person acquiring the stock.

Other income. The rules on income discussed in the other chapters of this publication also apply to a decedent's final return.

Deductions, Credits, and Exemptions

The standard deduction can be used to figure taxable income on the decedent's final return. However, the standard deduction cannot be taken if the decedent and surviving spouse file separate returns, and itemized deductions are elected by (or for) one spouse. In that event, the other spouse must itemize deductions. If the total of the decedent's itemized deductions are more than the decedent's standard deduction, the federal income tax will generally be less if itemized deductions are used. See Chapter 21.

Itemized deductions. If the decedent used the cash method of accounting, include only the expenses that the decedent paid before death. If the decedent used the accrual method, include only those expenses that the decedent accrued before death.

However, medical expenses paid for the care of the decedent may be treated as paid by the decedent at the time they were incurred, even if they are paid after death. See Chapter 22.

Standard deduction. Generally, the amount of the standard deduction for a decedent's final tax return is the same as it would have been had the deceased continued to live. A higher standard deduction is allowed only if the decedent was blind or age 65 or over at the time of death. If the decedent can be claimed as a dependent of another taxpayer, the amount of the standard deduction may be limited. See Chapter 21 for more information about determining the amount of the standard deduction.

Personal exemption. The personal exemption amount is allowed in full on a decedent's final tax return, unless the decedent can be claimed as a dependent on another taxpayer's return. See Chapter 3.

All deductions and credits discussed in this publication apply to the final return, if the decedent was eligible for the deduction or credit at the time of death.

Income tax withheld from the decedent's pay, pensions, or annuities before death, and any estimated income tax that was paid, must be claimed on the decedent's final return.

Survivors

Survivors can qualify for certain benefits when filing their own income tax returns.

A surviving spouse can file a joint return with the deceased spouse for the year of death if the survivor does not remarry before the end of that year. If there is a dependent child, the survivor may be entitled to use the standard deduction amount and the tax rates that apply to married individuals filing joint returns for the 2 following years. See *Qualifying Widows and Widowers* in Chapter 2.

If the decedent qualified as your dependent for the part of the year before death, you can claim the full exemption amount for the dependent on your tax return, regardless of when death occurred during the year. However, if you can claim the decedent as a dependent on your return, and a final return for the decedent is required to be filed, the amount of the personal exemption that can be claimed on the decedent's final return is zero and the amount of the standard deduction may be limited. See Chapters 3 and 21.

Income in Respect of the Decedent

All gross income that the decedent had a right to receive and that is not includible in the final return is income in respect of the decedent. Do not report this income on the final return of the decedent, but include it, for the tax year when received, in the gross income of:

1) The decedent's estate, if the estate acquired the right to receive the amount from the decedent, or
2) The person to whom the right to the income passed directly if the estate did not receive that right from the decedent, or
3) Any person to whom the estate properly distributes the right to receive the amount.

Example 1. Joe Jones owned and operated an orchard. He used the cash method of accounting. He sold and delivered $2,000 worth of fruit to a customer, but did not receive payment before his death. When the estate was settled, payment had not been made, and the estate gave the right to receive the payment to his niece as beneficiary. When she collects the $2,000, she must include it in her return. It is not reported on the final return of the decedent nor on the return of the estate.

Example 2. If, in Example 1, Joe Jones had used the accrual method of accounting, the income from the fruit sale must be included on his final return. Neither his estate nor his niece will realize income in respect of the decedent when the money is later paid.

Example 3. Mary Smith was entitled to a large salary payment at the date of her death. It was to be paid in five yearly payments. Her estate, after collecting two payments, gives the right to the remaining payments to you, the beneficiary. None of the payments would be included in the decedent's final return. The estate must include in its gross income, as income in respect of the decedent, the two payments it received. You must include in your gross income each of the three remaining payments as you receive them.

If you transfer your right to income in respect of a decedent, you must include in your income the larger of:

1) The amount you receive for the right, or
2) The fair market value of the right you transfer. Fair market value is defined in Chapter 15, under *Inherited Property.*

If you make a gift of such a right, you must include in your gross income the fair market value of the right at the time you make the gift.

The character (type) of the income you receive in respect of a decedent is the same as it would have been had the deceased continued to live. For example, if the income would have been a capital gain to the decedent, it will be a capital gain to you.

Interest on savings certificates that applies to the period from the date of the last payment to the date of death, but not received as of that date, is interest income in respect of a decedent. Interest attributable to a period after the decedent's death that becomes payable on the certificates after death is not income in respect of a decedent. Such interest, however, is ordinary income includible in the gross income of the respective recipients.

If you collect on an installment obligation (such as a mortgage or a note) you received from a decedent, you use the same gross profit percentage the decedent would have used to arrive at the part of each payment collected that represents profit. See Publication 537, *Installment Sales.*

If you sell or exchange an installment obligation you received from a decedent, the rules for disposition of installment obligations apply. See Publication 537. However, your basis for the obligation is the same as the decedent's basis, adjusted for all installment payments you received before the sale or exchange.

Expenses in Respect of the Decedent

Expenses in respect of the decedent are items such as business expenses, income-producing expenses, interest, and taxes, for which the decedent was liable, but which are not deductible on the decedent's final income tax return. These expenses will be allowed as a deduction to the estate of the decedent in the tax year paid. If the estate is not liable for them, they are deductible by the person who receives an interest in the decedent's property subject to these expenses.

Deduction of federal estate tax. If you include income in respect of a decedent in your gross income for any tax year, you may take as a deduction for that same year a part of the federal estate tax on the decedent's estate.

If the income is ordinary income, you may claim the deduction only as a miscellaneous itemized deduction on Schedule A (Form 1040). This deduction is not subject to the 2% limit on miscellaneous itemized deductions, discussed in Chapter 30.

If the income is capital gain income, then in figuring the maximum capital gain rate or any net capital loss limitation, the amount of the gain must be reduced, but not below zero, by the amount of any estate tax deduction attributable to such gain.

For more information on the income tax deduction for estate tax paid on income in respect of a decedent, see Publication 559.

5. Tax Withholding and Estimated Tax

Important Changes for 1990

Credit for estimated tax on Form 1040A. Beginning 1990, you can take credit for your estimated tax payments and make the election to apply your refund to your 1991 estimated tax on either Form 1040 or Form 1040A. Previously, you could use only Form 1040.

Short method for figuring the estimated tax penalty. Beginning 1990, if you owe a penalty for underpayment of estimated tax, you may be able to figure it using fewer computations. See *Short method for figuring the penalty* under *Underpayment Penalty*, later.

Important Changes for 1991

Some of the tax changes that you should consider when you figure your income tax withholding or estimated tax for 1991 are discussed in this section. For information on other changes, see Publication 553, *Highlights of 1990 Tax Changes.*

Personal exemption. For 1991, the personal exemption amount for you, your spouse, and each dependent has increased to $2,150.

Standard deduction. Individuals who do not itemize deductions have an increased standard deduction for 1991. See Publication 505, *Tax Withholding and Estimated Tax,* or the instructions for Form 1040–ES, *Estimated Tax for Individuals.*

Personal interest. Beginning in 1991, you can no longer deduct personal interest, such as interest on car loans or credit card balances for personal expenses.

Investment interest. Beginning in 1991, your deduction for investment interest is limited to your net investment income. For more information, see *Interest Expenses* under *Investment Expenses* in Publication 550, *Investment Income and Expenses.*

Self-employment tax. For 1991, the maximum amount of net earnings from self-employment subject to the tax has been increased to $53,400.

Expired tax items. You can no longer claim the following items:

- Exclusion for employer-provided educational assistance,
- Exclusion for employer-provided group legal services,
- Deduction for 25% of the health insurance costs of self-employed individuals,
- Targeted jobs credit,
- Business energy tax credit,
- Low-income housing credit, and
- Research and experimentation credit.

Proposed Changes for 1991

As this publication was being prepared for print, Congress was considering changes to the tax law that could affect your 1991 tax. The following were some of the proposals being considered.

- Increase the top tax rate for high-income individuals.
- Increase the the alternative minimum tax rate.
- Limit itemized deductions for high-income individuals.
- Increase the ceiling (currently $53,400 for 1991) on wages and self-employment income subject to the Medicare tax part of social security tax (1.45% each on employers and employees, 2.9% on self-employment income).
- Decrease the tax on for long-term capital gains.
- Increase the earned income credit.
- Extend some or all of the tax benefits that expired in 1990. (See *Expired tax items* under *Important Changes for 1991*, earlier.)

For information on late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes.*

The federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the year. There are two ways to pay as you go:

- ***Withholding.*** If you are an employee, your employer probably withholds income tax from your pay. Tax is also usually withheld from certain other income—including pensions, bonuses, commissions, and gambling winnings. In each case, the amount withheld is paid to the Internal Revenue Service in your name.
- ***Estimated tax.*** If you do not pay your tax through withholding, or do not pay enough tax that way, you might have to pay estimated tax. People who are in business for themselves generally will have to pay their tax this way. Estimated tax is used to pay not only income tax, but self-employment tax and alternative minimum tax as well.

This chapter explains both of these methods. It also explains how to take credit on your 1990 return for the tax that was withheld and for your estimated tax payments.

If you did not pay enough tax in 1990 either through withholding or by making estimated tax payments, you will have an underpayment of estimated tax, and you may have to pay a penalty. This ***underpayment penalty,*** and the exceptions to it, are discussed at the end of this chapter.

Withholding

Income tax is withheld from the following kinds of income:

Salaries and wages. Income tax is withheld from the pay of most employees. Your pay includes bonuses, commissions, and vacation allowances, in addition to your regular pay. It also includes reimbursements and other expense allowances paid under a nonaccountable plan. See *Supplemental Wages,* later.

Military retirees. Military retirement pay is treated in the same manner as regular pay for income tax withholding purposes, even though it is treated as a pension or annuity for other tax purposes.

Household workers. If you are a household worker, you can ask your employer to withhold income tax from your pay. Tax is withheld only if you want it withheld and your employer agrees to withhold it. If you do not have enough income tax withheld, you may have to make estimated tax payments, as discussed later under *Estimated Tax.*

Farmworkers. Income tax is generally withheld from your cash wages for work on a farm unless your employer:

1) Pays you cash wages of less than $150 during the year, and
2) Pays cash wages to all employees totaling less than $2,500 during the year.

If you receive cash wages not subject to withholding or noncash wages, you can ask your employer to withhold income tax. If your employer does not agree to withhold tax, or if not enough is withheld, you may have to make estimated tax payments, as discussed later under *Estimated Tax.*

Tips. The tips you receive and report to your employer while working as an employee are counted in with your regular wages to figure the amount withheld.

Taxable fringe benefits. Your employer will withhold income tax from most taxable fringe benefits paid to you either at a flat 20% rate or at your regular rate of withholding.

Sick pay. Income tax is withheld from sick pay you receive from your employer or an agent of your employer, just as it is from your

salaries and wages. If you receive sick pay from someone who is not acting as an agent of your employer, such as an insurance company, you can usually arrange to have income tax withheld from the sick pay. A special rule covers sick pay paid to you under certain union agreements.

Pensions and annuities. Income tax is withheld from your pension or annuity, unless you choose not to have it withheld.

Gambling winnings. Income tax is withheld from certain gambling winnings at a flat 20% rate.

Withholding on Salaries and Wages

The amount of income tax withheld from your regular pay depends on two things:

1) The amount you earn, and
2) The information you give your employer on Form W–4, *Employee's Withholding Allowance Certificate.*

Form W–4 includes three types of information that your employer will use to figure your withholding:

1) Whether to withhold at the single rate or at the lower married rate,
2) How many withholding allowances you claim (each allowance reduces the amount withheld), and
3) Whether you want an additional amount withheld.

If your income is low enough that you will not have to pay income tax for the year, you may be exempt from withholding. See *Exemption From Withholding,* later.

New job. When you start a new job, you must fill out Form W–4 and give it to your employer. Your employer should have copies of the form. If you later need to change the information you gave, you must fill out a new form.

If you go back to work after a period of unemployment, or if you work only part of the year, too much tax may be withheld. You may be able to avoid overwithholding if your employer agrees to use the part-year method, explained later.

Changing your withholding. Events during the year may change your marital status or the exemptions, adjustments, deductions, or credits you expect to claim on your return. When this happens, you may need to give your employer a new Form W–4 to change your withholding status or allowances.

You ***must*** give your employer a new Form W–4 within 10 days after:

1) Your divorce, if you have been claiming married status, or
2) Any event that decreases the withholding allowances you can claim.

Generally, you can submit a new Form W–4 at any time you wish to change your withholding allowances for any other reason.

If events in 1991 will decrease your withholding allowances for 1992, you must give your employer a new Form W–4 by December 2, 1991. If the event occurs in December 1991, submit a new Form W–4 within 10 days.

Part-year method. If you work only part of the year and your employer agrees to use the part-year withholding method, less tax will be withheld from each wage payment than would be withheld if you worked all year. For information about asking your employer to use the part-year method, see *Part-year method* under *Withholding on Salaries and Wages* in Chapter 1 of Publication 505.

Cumulative wage method. If you change your withholding allowances during the year, too much or too little tax may have been withheld for the period before you made the change. You may be able to compensate for this if your employer agrees to use the cumulative wage withholding method for the rest of the year. See *Cumulative wage method* under *Withholding on Salaries and Wages* in Chapter 1 of Publication 505 for information about asking your employer to use the cumulative wage method.

Checking your withholding. After you have given your employer a Form W–4, you can check to see whether the amount of tax withheld from your pay is too little or too much. See *Getting the Right Amount of Tax Withheld,* later. If too much or too little tax is being withheld, you should give your employer a new Form W–4 to change your withholding.

Completing Form W–4

The following discussions explain how to complete your Form W–4.

Marital status (line 3). The tax rates for married people filing a joint return are lower than those for single people. Therefore, there is a lower married withholding rate for people who can use the tax rates for joint returns. Everyone else must have tax withheld at the higher single rate.

You must claim ***single*** status if either of the following applies.

1) **You are single.** If you are divorced, or separated from your spouse under a court decree of separate maintenance, you are considered single.
2) **You are married, but you are neither a citizen nor a resident of the United States,** or your spouse is neither a citizen nor a resident of the United States. However, if one of you is a citizen or a resident, you can choose to have the other treated as a resident. You can then file a joint return and claim married status on your Form W–4. See *Nonresident Spouse Treated as a Resident* in Chapter 1 of Publication 519, *U.S. Tax Guide for Aliens,* for more information.

You can claim ***married*** status if either of the following applies.

1) **You are married and neither you nor your spouse is a nonresident alien.** You are considered married for the whole year even if your spouse died during the year.
2) **You expect to be able to file your return as a qualifying widow or widower.** You usually can use this filing status if your spouse died within the previous two years and you provide a home for your dependent child. See *Qualifying Widows and Widowers* in Chapter 2.

Some married people find that they do not have enough tax withheld at the married rate. This can happen, for example, when both spouses work. Therefore, even if you qualify for the married rate, you can still choose to have tax withheld at the higher single rate.

Withholding allowances (line 4). The more allowances you claim on Form W–4, the less income tax your employer will withhold. You will have the most tax withheld if you claim "0" allowances. The number of allowances you can claim depends on:

1) How many exemptions you can take on your tax return,
2) Whether you have income from more than one job,
3) What deductions, adjustments to income, and credits you expect to have for the year, and
4) Whether you will file as head of household.

If you are married, it also depends on whether your spouse also works and claims any allowances on his or her own Form W–4. If you both work, you may figure your combined allowances and divide them between you. See *Two jobs,* later.

Form W–4 worksheets. Form W–4 has worksheets to help you figure how many withholding allowances you can claim. The worksheets are for your own records. Do not give them to your employer.

You are not required to use the worksheets if you use a more accurate method of withholding. See *Alternative method of figuring withholding allowances* under *Completing Form W–4 and Worksheets* in Chapter 1 of Publication 505 for more information.

Withholding and estimated tax. Before you figure your withholding allowances, use your estimated adjustments, deductions, and tax credits to reduce your estimated tax. The Deductions and Adjustments Worksheet on page 2 of Form W–4 does this for you. But if you use an alternative method of figuring withholding allowances, take into account only the amount of these items remaining after you have reduced your estimated tax to zero.

Two jobs. If you have income from two jobs at the same time, or if both you and your spouse are employed and you expect to file a joint return, complete only one set of Form W–4 worksheets. Then split your allowances between the Forms W–4 for each job. You cannot claim the same allowances with more than one employer at the same time. You can claim all your allowances with one employer and none with the other, or divide them in any other way you wish.

If both you and your spouse are employed and you expect to file a joint return, figure your withholding allowances using your combined income, adjustments, deductions, exemptions, and credits. You can divide your total allowances in any way you wish, but you cannot claim an allowance that your spouse also claims.

If you and your spouse expect to file separate returns, figure your allowances separately based on your own individual income, adjustments, deductions, exemptions, and credits.

Personal Allowances Worksheet. Use the Personal Allowances Worksheet on page 1 of Form W–4 to figure your withholding allowances for exemptions. Add the special allowance for only one job, the allowance for head of household status, and the allowance for the child and dependent care credit (if they apply) to your total allowances.

Special allowance (worksheet line B). You can claim the special allowance if any of the following apply.

1) You are single, and you have only one job at a time.

2) You are married, you have only one job at a time, and your spouse does not work.

3) Your wages from a second job or your spouse's wages (or the total of both) are $2,500 or less.

Head of household (worksheet line E). You can claim one additional withholding allowance if you expect to file as head of household on your tax return. To find out whether you qualify, see *Head of Household* in Chapter 2.

Child and dependent care credit (worksheet line F). You can claim one additional withholding allowance if you expect to have at least $1,500 of qualifying child or dependent care expenses that you plan to claim a credit for on your tax return. For information on this credit, see Chapter 33.

Instead of using line F, you can choose to figure allowances for the child and dependent care credit (and other credits you expect to claim on your return) as explained next.

Deductions and Adjustments Worksheet. To adjust your withholding allowances for deductions, adjustments, tax credits, and nonwage income, use the Deductions and Adjustments Worksheet on page 2 of Form W–4.

Tax credits. You can take tax credits into account by adding an extra amount on line 5 of the worksheet. You must use special tables to change the credit amount to an equivalent deduction amount. See *Tax credits* under *Deductions and Adjustments Worksheet* in Chapter 1 of Publication 505 for information.

Nonwage income. You may need to reduce the number of withholding allowances you would otherwise claim if you expect to receive taxable nonwage income. This includes interest, dividends, net rental income, unemployment compensation, alimony received, gambling winnings, prizes and awards, hobby income, capital gains, royalties, and partnership income.

Two-Earner/Two-Job Worksheet. You may need to complete this worksheet if you have two jobs or a working spouse. You can also use this worksheet to figure additional withholding if you expect to owe an amount other than income tax, such as self-employment tax.

For more information about Form W–4 and a filled-in example, see *Withholding on Salaries and Wages* in Chapter 1 of Publication 505.

Getting the Right Amount of Tax Withheld

In most situations, the tax withheld from your pay will be close to the tax you figure on your return if you accurately complete all the Form W–4 worksheets that apply to you and give your employer a new form when changes occur. But because the worksheets and withholding methods do not account for all possible situations, you may not be getting the right amount withheld. This is most likely to happen in the following situations.

1) You are married and both you and your spouse work.

2) You have more than one job at a time.

3) You have nonwage income, such as interest, dividends, alimony, or self-employment income.

4) You will owe additional amounts with your return, such as self-employment tax.

5) Your withholding is based on obsolete Form W–4 information for a substantial part of the year.

To make sure you are getting the right amount of tax withheld, get Publication 919, *Is My Withholding Correct for 1991?* It will help you compare the total tax to be withheld in 1991 with the tax you can expect to figure on your return. It also will help you determine how much additional withholding is needed each payday to avoid owing tax when you file your return. If you do not have enough tax withheld, you may have to make estimated tax payments, as explained under *Estimated Tax*, later.

Rules Your Employer Must Follow

The following are some of the withholding rules that can affect how you fill out your Form W–4 and how you handle problems that may arise. For other rules, see *Rules Your Employer Must Follow* under *Withholding on Salaries and Wages* in Chapter 1 of Publication 505.

Putting a new Form W–4 into effect. When you start a new job, your employer will give you a Form W–4 to fill out. The information you give on the form will be used to figure your withholding, beginning with your first payday.

If you later fill out a new Form W–4, your employer can put it into effect as soon as it is practical to do so. The deadline for putting it into effect is the start of the first payroll period ending 30 or more days after you turn it in.

Withholding without a Form W–4. If you do not give your employer a completed Form W–4, your employer must withhold at the highest rate—as if you were single and claimed no allowances.

Repaying withheld tax. If you find you are having too much tax withheld because you did not claim all the withholding allowances you are entitled to, you should give your employer a new Form W–4. Your employer cannot repay you any of the tax withheld under your old Form W–4.

However, if your employer has withheld more than the correct amount of tax for the Form W–4 you have in effect, you do not have to fill out a new Form W–4 to have your withholding lowered to the correct amount. Your employer can repay you the amount that was incorrectly withheld. If you are not repaid, you will receive credit on your tax return for the full amount actually withheld.

Exemption From Withholding

If you claim exemption from withholding, your employer will not withhold federal income tax from your wages. The exemption applies only to income tax, not to social security (FICA) tax.

You can claim exemption from withholding for 1991 only if both the following situations apply.

1) For 1990 you had a right to a refund of all income tax withheld because you had no tax liability.

2) For 1991 you expect a refund of all income tax withheld because you expect to have no tax liability.

Use the *Exemption From Withholding on Form W–4* chart on the next page to help you decide whether you can claim exemption. (Do not use the chart if you are 65 or older or blind, or if you will itemize deductions or claim dependents or tax credits on your 1991 return. These situations are discussed later.)

Student. If you are a student, you are not automatically exempt. But if you work only part time and during the summer, you may qualify for exemption.

Example 1. You are a high school student and expect to earn $2,400 from a summer job. You do not expect to have any other income during 1991, and your parents will be able to claim you as a dependent on their tax return. You worked last summer and had $200 federal income tax withheld from your pay. The entire $200 was refunded when you filed your 1990 return. Using the *Exemption From Withholding on Form W–4* chart, you find that you ***can*** claim exemption from withholding.

Example 2. The facts are the same as in Example 1, except that you have a savings account and expect to have $20 interest income in 1991. Using the *Exemption From Withholding on Form W–4* chart, you find that you ***cannot*** claim exemption from withholding because your unearned income will be $1 or more and your total income will be more than $500.

Age 65 or older or blind. If you are 65 or older or blind, use one of the worksheets in Chapter 1 of Publication 505, under *Exemption From Withholding*, to help you decide whether you can claim exemption from withholding. (Do not use either of those worksheets if you will itemize deductions or claim dependents or tax credits on your 1991 return—see the following discussion instead.)

Itemizing deductions or claiming dependents or tax credits. If you had no tax liability for 1990 and you will itemize your deductions or claim dependents or tax credits on your 1991 return, use the 1991 Estimated Tax Worksheet in Form 1040–ES, *Estimated Tax for Individuals*, to figure your 1991 expected tax liability. You can claim exemption from withholding only if your total expected tax liability (line 13c of the worksheet) is zero.

Claiming exemption. To claim exemption, you must give your employer a Form W–4 with lines 6 and 7 completed.

Your employer must send the IRS a copy of your Form W–4 if you claim exemption from withholding and your pay is expected to usually be more than $200 a week. If it turns out that you do not qualify for exemption, the IRS will send both you and your employer a written notice.

If you claim exemption, but later your situation changes so that you will have to pay income tax after all, you must file a new Form W–4 within 10 days after the change. If you claim exemption in 1991, but you expect to owe income tax for 1992, you must file a new Form W–4 by December 2, 1991.

An exemption is good for only one year. You must give your employer a new Form W–4 by February 15 each year to continue your exemption.

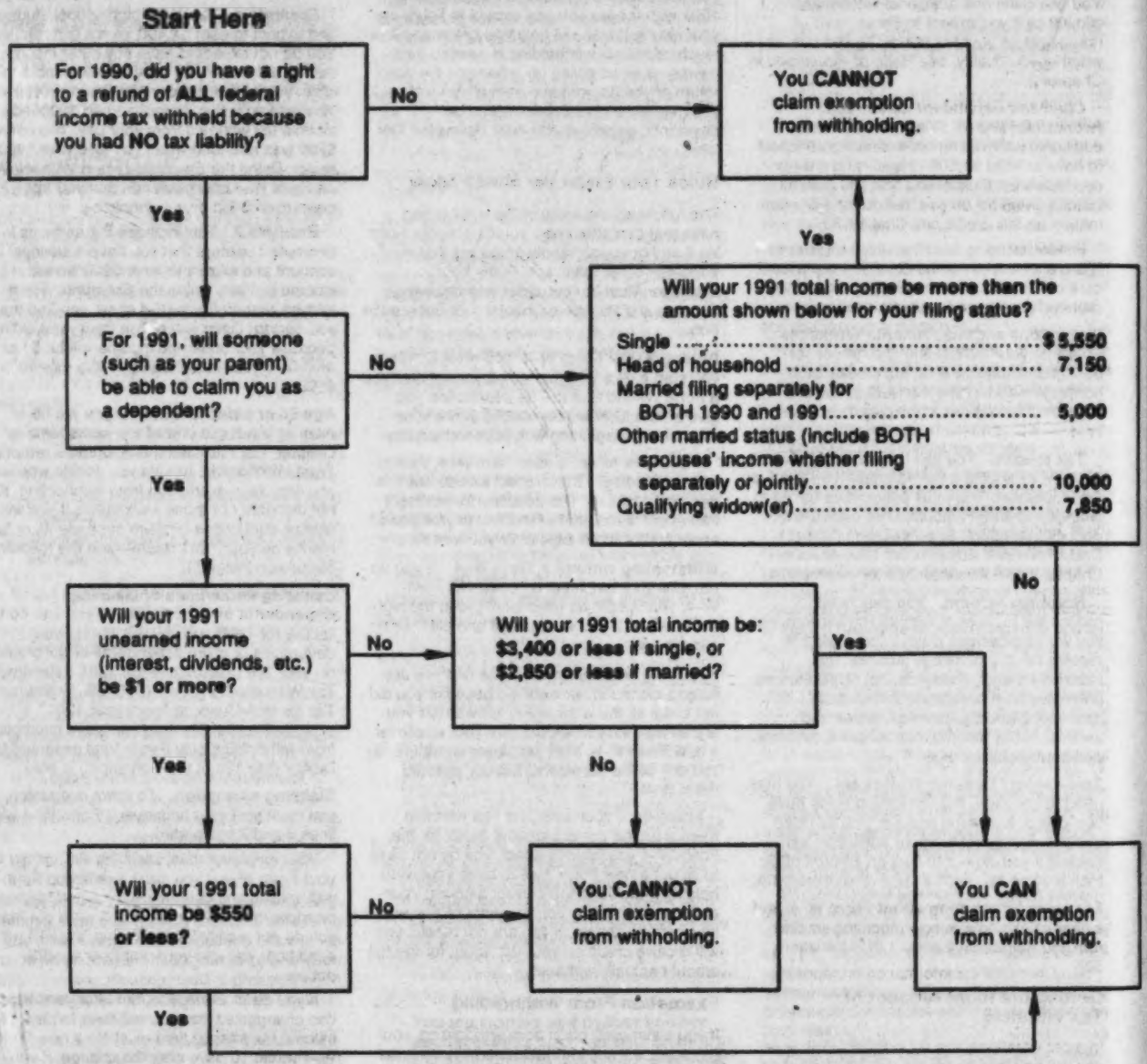
Supplemental Wages

Supplemental wages include bonuses, commissions, overtime pay, and certain sick pay. Your employer or other payer of supplemental wages may withhold income tax from these wages at a flat 20% rate or figure withholding using the same method used for your regular wages.

Also see *Withholding on Sick Pay*, later.

Exemption from Withholding on Form W-4

Do not use this chart if you are 65 or older or blind, or if you will itemize your deductions or claim dependents or tax credits. Instead, see the discussions in this chapter under *Exemption From Withholding*.


Start Here
For 1990, did you have a right to a refund of ALL federal income tax withheld because you had NO tax liability?
No
You CANNOT claim exemption from withholding.
Yes
Yes
Will your 1991 total income be more than the amount shown below for your filing status?
Single $5,550
Head of household 7,150
Married filing separately for BOTH 1990 and 1991..... 5,000
Other married status (include BOTH spouses' income whether filing separately or jointly..... 10,000
Qualifying widow(er)..... 7,850
For 1991, will someone (such as your parent) be able to claim you as a dependent?
No
Yes
No
Will your 1991 unearned income (interest, dividends, etc.) be $1 or more?
No
Will your 1991 total income be: $3,400 or less if single, or $2,850 or less if married?
Yes
Yes
No
Will your 1991 total income be $550 or less?
No
You CANNOT claim exemption from withholding.
You CAN claim exemption from withholding.
Yes

Expense allowances. Reimbursements or other expense allowances paid by your employer under a nonaccountable plan are treated as supplemental wages. A nonaccountable plan is an arrangement that does not require you to substantiate your business expenses or does not require you to return your employer's payments that are more than the substantiated expenses.

Reimbursements or other expense allowances paid under an accountable plan are treated as paid under a nonaccountable plan to the extent they are more than your substantiated expenses, unless you return the excess payments within a reasonable period of time.

For more information about accountable and nonaccountable expense allowance plans, see *If You Were Reimbursed* under *How to Report* in Chapter 28.

Penalties

If you make statements or claim withholding allowances on your Form W–4 that reduce the amount of tax withheld, and there is no reasonable basis for such statements or allowances at the time you prepare your Form W–4, you may have to pay a penalty of $500.

There is also a criminal penalty for willfully supplying false or fraudulent information on your Form W–4 or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction can be either a fine of up to $1,000 or imprisonment for up to one year, or both.

These penalties will apply if you deliberately and knowingly falsify your Form W–4 in an attempt to reduce or eliminate the proper withholding of taxes. A simple error—an honest mistake—will not result in a penalty. For example, a person who has tried to figure the number of withholding allowances correctly, but claims seven when the proper number is six, will not be penalized.

Withholding on Tips

The tips you receive while working on your job are considered part of your pay. They must be included on your tax return on the same line as your regular pay. However, tax is not withheld directly from tip income, as it is from your regular pay. Nevertheless, the tips you report to your employer will be taken into account when your employer figures how much to withhold from your regular pay.

See Chapter 7 for information on reporting your tips to your employer. For more information on the withholding rules for tip income, see Publication 531, *Reporting Income From Tips.*

Figuring the amount to withhold. The tips you report to your employer are counted as part of your income for the month you report them. Your employer can figure your withholding in either of two ways:

1) By withholding at the regular rate on the sum of your pay plus your reported tips, or
2) By withholding at the regular rate on your pay plus an amount equal to 20% of your reported tips.

Pay too low. If your regular pay is too low for your employer to withhold all the tax (including social security or railroad retirement tax) due on your pay plus your tips, you may give your employer money to cover the shortage.

If you do not give your employer money to cover the shortage, your employer will first withhold as much social security or railroad retirement tax as possible, up to the proper amount, and then withhold income tax up to the full amount of your pay. If not enough tax is withheld, you may have to make estimated tax payments. When you file your return, you also may have to pay any social security or railroad retirement tax your employer could not withhold.

Allocated tips. Your employer should not withhold income tax, social security tax, or railroad retirement tax on any allocated tips. Withholding is based only on your pay plus your ***reported tips.*** Any incorrectly withheld tax should be refunded to you. See *Tip Allocation* in Chapter 7 for more information.

Withholding on Taxable Fringe Benefits

The value of certain noncash fringe benefits you receive from your employer is considered part of your pay. Your employer generally must withhold income tax on these benefits from your regular pay for the period the benefits are paid or are treated as paid.

For information on taxable fringe benefits, see *Fringe Benefits* under *Employee Compensation* in Chapter 6.

Your employer can choose not to withhold income tax on the value of your personal use of a car, truck, or other highway motor vehicle provided by your employer. Your employer must notify you if this choice is made.

When benefits are treated as paid. Your employer can choose to treat a fringe benefit as paid by the pay period, or by the quarter, or on some other basis as long as the benefit is treated as paid at least once a year. The benefit can be treated as paid on one or more dates during the year, even if you get the entire benefit at one time.

Special rule. Your employer can choose to treat a benefit actually provided during November or December as paid in the next year. Your employer must notify you if this rule is used.

Example. Your employer treats the value of benefits paid from November 1, 1989, through October 31, 1990, as paid to you in 1990. To determine the total value of benefits paid to you in 1991, your employer will add the value of any benefits paid in November and December of 1990 to the value of any benefits paid in January through October of 1991.

Exceptions. Your employer cannot choose when to withhold tax on certain benefits. These benefits are transfers of either real property or personal property of a kind normally held for investment (such as stock). Your employer must withhold tax on these benefits when they are actually transferred.

How withholding is figured. Your employer may either add the value of a fringe benefit to your regular pay and figure income tax withholding on the total or withhold 20% of the benefit's value.

If the benefit's actual value cannot be determined when it is paid or treated as paid, your employer may use a reasonable estimate. Your employer must determine the actual value of the benefit by January 31 of the next year. If the actual value is more than the estimate, your employer must pay the IRS any additional withholding tax required. Your employer has until April 1 of that next year to recover from you the additional tax paid to the IRS on your behalf.

How your employer reports your benefits. Your employer must report on Form W–2, *Wage and Tax Statement,* the total of the taxable fringe benefits paid or treated as paid to you during the year and the income tax withheld for the benefits. These amounts can be shown either on the Form W–2 for your regular pay or on a separate Form W–2. For more information, see *How to Report Fringe Benefits* under *Employee Compensation* in Chapter 6.

Withholding on Sick Pay

"Sick pay" is a payment to you to replace your regular wages while you are temporarily absent from work due to sickness or personal injury. To qualify as "sick pay," it must be paid under a plan to which your employer is a party.

If you receive sick pay from your employer or an agent of your employer, income tax must be withheld just as it is from your regular pay.

However, if you receive sick pay from a third party who is not acting as an agent of your employer, income tax will be withheld only if you choose to have it withheld. See *Form W–4S,* later.

If you receive payments under a plan in which your employer does not participate, the payments are not sick pay and usually are not taxable.

Union agreements. If you receive sick pay under a collective bargaining agreement between your union and your employer, the amount of income tax withholding may be determined by the agreement. See your union representative or your employer for more information.

Form W–4S. If you choose to have income tax withheld from sick pay paid by a third party who is not an agent of your employer, you must fill out Form W–4S, *Request for Federal Income Tax Withholding From Sick Pay.* Its instructions contain a worksheet you can use to figure the amount you want withheld. They also explain restrictions that may apply.

Give the completed form to the payer of your sick pay. The payer must withhold according to your directions on the form.

If you do not request withholding on Form W–4S, or if you do not have enough tax withheld, you may have to make estimated tax payments. If you do not pay enough estimated tax or have enough income tax withheld, you may have to pay a penalty. See *Who Must Make Estimated Tax Payments* and *Underpayment Penalty,* later in this chapter.

Withholding on Pensions and Annuities

Income tax usually will be withheld from your pension or annuity distributions, unless you choose not to have it withheld. This rule applies to distributions from:

1) An individual retirement arrangement (IRA),
2) A life insurance company under an endowment, annuity, or life insurance contract,
3) A pension, annuity, or profit-sharing plan,
4) A stock bonus plan, and
5) Any other plan that defers the time you receive compensation.

The amount withheld depends on whether you receive payments spread out over more

than one year (periodic payments) or whether you receive all the payments within one year (nonperiodic payments).

Nontaxable part. A part of your pension or annuity may not be taxable. This part will be determined by rules discussed in Chapter 11. Income tax will not be withheld from the part of your pension or annuity that is nontaxable. Therefore, the tax withheld will be figured on, and cannot be more than, the taxable part.

Periodic Payments

Withholding from periodic payments of a pension or annuity is figured in the same way as withholding from salaries and wages. To tell the payer of your pension or annuity how much you want withheld, fill out **Form W–4P**, *Withholding Certificate for Pension or Annuity Payments*, or a similar form provided by the payer. Follow the rules discussed under *Withholding on Salaries and Wages*, earlier, to fill out your Form W–4P.

The withholding rules for pensions and annuities differ from those for salaries and wages in the following ways.

1) If you do not fill out a withholding certificate, tax will be withheld as if you were married and were claiming three withholding allowances.
2) Your certificate will not be sent to the IRS regardless of the number of allowances you claim on it.
3) You can choose not to have tax withheld, regardless of how much tax you owed last year or expect to owe this year. You do not have to qualify for exemption. See *Choosing Not to Have Income Tax Withheld*, later.
4) If you do not give the payer your social security number (in the required manner) or the IRS notifies the payer, before any payment or distribution is made, that you gave it an incorrect social security number, tax will be withheld as if you were single and were claiming no withholding allowances.

Note. Military retirement pay generally is treated in the same manner as wages and not as a pension or annuity for income tax withholding purposes. Military retirees should use Form W–4, not Form W–4P.

Nonperiodic Payments

Tax will be withheld at a 10% rate on any nonperiodic payments you receive, unless they are part of a "qualified total distribution." The amount of tax withheld from a qualified total distribution is specified in tables.

A qualified total distribution is payment within one year of your entire interest in a pension, profit-sharing, stock bonus, or qualified annuity plan.

Because withholding on nonperiodic payments does not depend on withholding allowances or whether you are married or single, you cannot use Form W–4P to tell the payer how much to withhold. But you can use Form W–4P to specify that an additional amount be withheld. You can also use Form W–4P to choose not to have tax withheld or to revoke a choice not to have tax withheld.

Choosing Not to Have Income Tax Withheld

You can choose not to have income tax withheld from your pension or annuity, whether the payments are periodic or nonperiodic. The payer will tell you how to make this choice. If Form W–4P is used, check the box on line 1 to make this choice. This choice will stay in effect until you decide you want withholding.

If you do not give the payer your social security number (in the required manner) or the IRS notifies the payer, before any payment or distribution is made, that you gave it an incorrect social security number, your choice not to have tax withheld will not be honored.

If you choose not to have any income tax withheld from your pension or annuity, or if you do not have enough withheld, you may be required to make estimated tax payments. See *Estimated Tax*, later.

If you do not pay enough tax either through estimated tax or withholding, you may have to pay a penalty. This penalty is discussed later under *Underpayment Penalty*.

Outside United States. If you are a U.S. citizen or resident alien who chooses not to have tax withheld from pension or annuity benefits, you must give the payer of the benefits a home address in the United States or in a U.S. possession. Otherwise, the payer must withhold tax. For example, the payer would have to withhold tax if you provide a U.S. address for a nominee, trustee, or agent to whom the benefits are to be delivered, but do not provide your own home address in the United States or in a U.S. possession.

Revoking a choice not to have tax withheld. If you want to revoke your choice not to have tax withheld, the payer of your pension or annuity will tell you how. If the payer gives you Form W–4P, write "Revoked" by the checkbox on line 1 of the form.

If you get periodic payments and do not complete the rest of the form, tax will be withheld as if you were married and were claiming three allowances. If you want tax withheld at a different rate, you must complete the rest of the form.

Notice required of payer. The payer of your pension or annuity is required to send you a notice telling you about your right to choose not to have tax withheld.

Withholding on Gambling Winnings

Income tax is withheld from certain kinds of gambling winnings. The amount withheld is 20% of the proceeds (the amount of your winnings minus the amount of your bet).

Gambling winnings from the following sources are subject to income tax withholding:

1) A state lottery, if the proceeds are more than $5,000,
2) A wagering pool, sweepstakes, or lottery (such as a drawing or church raffle), if the proceeds are more than $1,000, and
3) Any other wager, including wagers on horse races, dog races, and jai alai, if the proceeds are more than $1,000 and at least 300 times the amount of the bet.

Other gambling winnings, including winnings from bingo, keno, and slot machines, are not subject to income tax withholding. If you receive gambling winnings not subject to withholding, you may need to make estimated tax payments. (See *Estimated Tax*, later.)

If you do not pay enough tax through withholding or estimated tax payments, you may be subject to a penalty. (See *Underpayment Penalty*, later.)

Form W–2G. If income tax is withheld from your gambling winnings, you should receive a Form W–2G, *Statement for Recipients of Certain Gambling Winnings*, showing the amount you won and the amount withheld. For more information, see *Withholding on Gambling Winnings* in Chapter 1 of Publication 505.

Backup Withholding

Banks or other businesses that pay you certain kinds of income must file an information return (Form 1099) with the IRS. The information return shows how much you were paid during the year. It also includes your name and taxpayer identification number (TIN). Your TIN is either a social security number or an employer identification number.

These payments generally are not subject to withholding. However, "backup" withholding is required in certain situations. Backup withholding can apply to most kinds of payments that are reported on Form 1099.

Payments made to you are subject to backup withholding at a flat 20% rate in the following situations.

1) You do not give the payer your TIN in the required manner.
2) The IRS notifies the payer that the TIN you gave is incorrect.
3) You are required, but fail, to certify that you are not subject to backup withholding.
4) The IRS notifies the payer to start withholding on interest or dividends because you have underreported interest or dividends on your income tax return. The IRS will do this only after it has mailed you four notices over a 120-day period.

See *Backup Withholding* in Chapter 1 of Publication 505 for more information.

Penalties. There are civil and criminal penalties for giving false information to avoid backup withholding. The civil penalty is $500. The criminal penalty, upon conviction, is a fine of up to $1,000, or imprisonment of up to one year, or both.

Estimated Tax

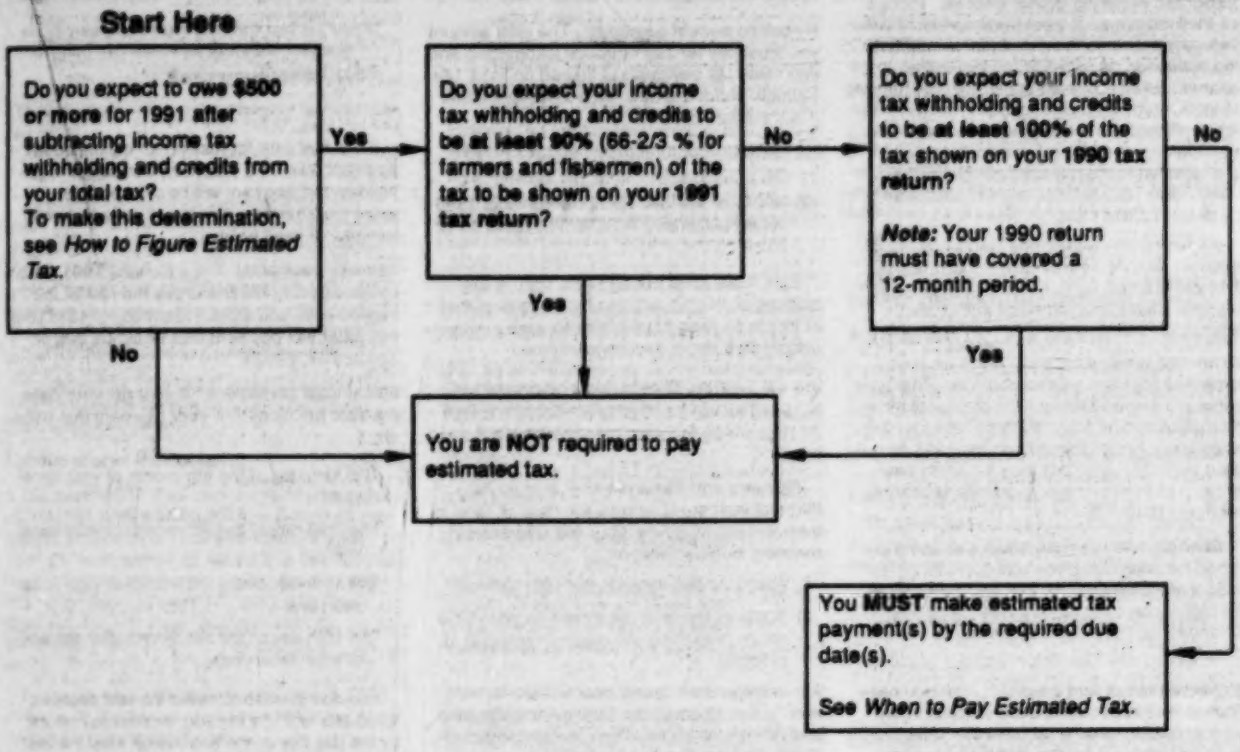
Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, unemployment compensation, interest, dividends, alimony, rent, gains from the sale of assets, prizes, and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough. To figure and pay estimated tax, use **Form 1040–ES**, *Estimated Tax for Individuals*.

Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on Form 1040. If you do not pay enough through withholding or by making estimated tax payments, you may be charged a penalty. If you do not pay enough by the due date of each payment period (see *When to Pay Estimated Tax*, later), you may be charged a penalty even if you are due a refund when you file your tax return. For information on when the penalty applies, see *Underpayment Penalty*, later.

Who Must Make Estimated Tax Payments

Generally, you must make estimated tax payments for 1991 if you expect to owe, after subtracting your withholding and credits, at

Who Must Pay Estimated Tax


Start Here
Do you expect to owe $500 or more for 1991 after subtracting income tax withholding and credits from your total tax?
To make this determination, see How to Figure Estimated Tax.
Yes
Do you expect your income tax withholding and credits to be at least 90% (66-2/3 % for farmers and fishermen) of the tax to be shown on your 1991 tax return?
No
Do you expect your income tax withholding and credits to be at least 100% of the tax shown on your 1990 tax return?
Note: Your 1990 return must have covered a 12-month period.
No
Yes
Yes
No
You are NOT required to pay estimated tax.
You MUST make estimated tax payment(s) by the required due date(s).
See When to Pay Estimated Tax.

least $500 in tax for 1991, and you expect your withholding and credits to be less than the smaller of:

1) 90% of the tax to be shown on your 1991 tax return, or
2) 100% of the tax shown on your 1990 tax return (assuming the return covered all 12 months).

See the *Who Must Pay Estimated Tax* chart in this chapter for more help.

If all your 1991 income will be subject to income tax withholding, you probably do not need to make estimated tax payments.

No tax liability last year. You do not have to pay estimated tax for 1991 if you had no tax liability for your 1990 tax year and you were a U.S. citizen or resident for the whole year. Your 1990 tax year must have been a 12-month period.

You had no tax liability for 1990 if your total tax (defined later under *Required annual payment*) was zero or you were not required to file an income tax return.

Married taxpayers. To figure whether you must make estimated tax payments for 1991, apply the rules discussed here to your 1991 separate estimated income. If you can make joint estimated tax payments, you can apply these rules on a joint basis.

You and your spouse can make joint payments of estimated tax even if you are not living together.

You and your spouse cannot make joint estimated tax payments if you are separated under a decree of divorce or separate maintenance. Also, you cannot make joint estimated tax payments if either spouse is a nonresident alien or if you have different tax years.

Whether you and your spouse make joint estimated tax payments or separate payments will not affect your choice of filing a joint tax return or separate returns for 1991.

If you and your spouse make joint payments and then file separate returns, you can divide your estimated tax payments between your returns. See *Estimated Tax* under *Credit for Withholding and Estimated Tax*, later.

Change from 1990 joint return or separate return. If you plan to file a joint return with your spouse for 1991, but you filed separate returns for 1990, your 1990 tax is the total of the tax shown on your separate returns.

If you plan to file a separate return for 1991, but you filed a joint return with your spouse for 1990, your 1990 tax is your share of the tax on the joint return. To figure your share, first figure the tax both you and your spouse would have paid had you filed separate returns for 1990. Then multiply your joint tax liability by the following fraction:

$$\frac{\text{Your separate tax liability}}{\text{Both spouses' separate tax liabilities}}$$

Example. Joe and Phyllis filed a joint return for 1990 showing taxable income of $48,000 and a tax of $9,229. Of the $48,000 taxable income, $40,000 was attributable to Joe and $8,000 was attributable to Phyllis. Joe figures his share of the tax on the joint return as follows:

Tax on $40,000 based on a separate return	$ 9,139
Tax on $8,000 based on a separate return	1,204
Total	$10,343
Joe's portion of total ($9,139 ÷ $10,343)	88%
Joe's share of joint return tax ($9,229 × 88%)	$ 8,122

Aliens. The requirements for making estimated tax payments also apply to resident and nonresident aliens. If you are a nonresident alien who must make estimated tax payments, use **Form 1040-ES(NR)**, *U.S. Estimated Tax for Nonresident Alien Individuals.*

How to Figure Estimated Tax

To figure your estimated tax, you must figure your expected adjusted gross income, taxable income, and taxes and credits for the year.

When figuring your 1991 estimated tax, it may be helpful to use your income, deductions, and credits for 1990 as a starting point. You must be careful to make adjustments both for changes in your own situation and for recent changes in the tax law. For 1991, there are several important changes in the law. These changes are discussed under *Important Changes for 1991* at the beginning of this chapter.

Form 1040-ES includes a worksheet to help you figure your estimated tax. Keep the worksheet for your records.

For additional information on how to figure your estimated tax for 1991, see Chapter 2 of

Publication 505, *Tax Withholding and Estimated Tax.*

Expected adjusted gross income. Include all the income you expect to receive during the year, even income that is subject to withholding. However, do not include income that is tax exempt. Be sure to subtract all the adjustments to income you expect to take on your 1991 tax return. These are the adjustments shown on the 1990 Form 1040, other than line 26, that are included in the total on line 30. On the 1990 Form 1040A, these are the adjustments on lines 15a and 15b.

If your income will include income from self-employment, figure your self-employment tax first and subtract half of it as an adjustment to income. (See *Expected taxes and credits,* later.)

Expected taxable income. Reduce your expected adjusted gross income by either your expected itemized deductions or your standard deduction and by a $2,150 deduction for each exemption. For information on the 1991 standard deduction amounts, see the chart near the end of Publication 505 or the instructions for Form 1040–ES.

Caution. As this publication was being prepared for print, Congress was considering a proposal that would limit itemized deductions for high income individuals. See *Proposed Changes for 1991* at the beginning of this chapter.

Expected taxes and credits. After you have figured your expected taxable income, figure your expected income tax. Use the 1991 Tax Rate Schedules near the end of Publication 505 or in the Form 1040–ES instructions. For the special method that must be used to figure tax on the income of a child under [illegible] who has more than $1,050 investment income ($1,000 for 1990), see Chapter 32.

Add your expected additional taxes from Form 4970, *Tax on Accumulation Distribution of Trusts,* and Form 4972, *Tax on Lump-Sum Distributions.* Subtract your expected credits. These are the credits shown on the 1990 Form 1040 that are included in the total on line 46. (Certain credits included on line 44 have expired. See *Important Changes for 1991,* at the beginning of this chapter.) On the 1990 Form 1040A, these are the credits on lines 24a and 24b. If your credits are more than your taxes, use "–0–" as the result.

Add your expected self-employment tax and other taxes. For 1991, the self-employment tax is 15.3% of the ***smaller*** of:

1) 92.35% of your net earnings from self-employment, or
2) $53,400 minus your wages subject to social security or railroad retirement tax.

Other taxes are those shown on lines 49, 50, and 52 of the 1990 Form 1040, plus advance earned income credit payments on line 53 and any write-in amounts on line 54. On the 1990 Form 1040A, include as "other tax" any advance earned income credit payments on line 26.

Finally, subtract your expected earned income credit and fuel tax credit. The result is your expected total tax for 1991.

Caution. As this publication was being prepared for print, Congress was considering a proposal that would increase the ceiling on self-employment income subject to the Medicare tax part of the self-employment tax. See *Proposed Changes for 1991* at the beginning of this chapter.

Required annual payment. The total amount you must pay for 1991 through withholding and estimated tax payments is figured on lines 14a through 14c of the Estimated Tax Worksheet. It is the ***smaller*** of:

1) 90% of your total expected tax for 1991, or
2) 100% of the total tax shown on your 1990 return (assuming the return covered all 12 months).

Your ***1990 total tax*** on Form 1040 is the amount on line 54 reduced by the total of the amounts on lines 51, 57, and 60, any uncollected social security or railroad retirement tax on tips included on line 54, and any tax from Form 5329 (other than Part II) included on line 52. On Form 1040A, it is line 27 reduced by line 28c. On Form 1040EZ, it is line 7.

Farmers and fishermen. If at least two-thirds of your gross income for 1990 or 1991 is from farming or fishing, your required annual payment is the smaller of:

1) 66⅔% of your total tax for 1991, or
2) 100% of the total tax shown on your 1990 return (assuming the return covered all 12 months).

For definitions of "gross income from farming" and "gross income from fishing," see *Farmers and Fishermen* under *When to Pay Estimated Tax* in Chapter 2 of Publication 505.

Total estimated tax payments. The total amount you must pay for 1991 through estimated tax payments is figured on lines 15 and 16 of the Estimated Tax Worksheet by subtracting your expected withholding from your required annual payment. This total usually must be paid in four equal installments. (See *When to Pay Estimated Tax* and *How to Figure Each Payment,* later.)

However, you are not required to make estimated tax payments if your total expected tax on line 13c, minus your expected withholding on line 15, is less than $500.

Withholding. Your expected withholding for 1991 (line 15 of the Estimated Tax Worksheet) includes the income tax you expect to be withheld from all sources (wages, pensions and annuities, etc.). It also includes excess social security, railroad retirement, and Medicare tax you expect to be withheld from your wages. (An excess usually will be withheld if you have two or more employers during 1991 who pay you a total of more than $53,400.)

When to Pay Estimated Tax

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific payment due date. If you do not pay enough tax by the due date of each of the payment periods, you may be charged a penalty even if you are due a refund when you file your income tax return. The following chart gives the payment periods and due dates.

For the period:	Due date:
Jan. 1* through Mar. 31	April 15
April 1 through May 31	June 15
June 1 through Aug. 31	September 15
Sept. 1 through Dec. 31	January 15 next year**

*If your tax year does not begin on January 1, see *Fiscal year taxpayers,* later.

**See *January payment,* next.

If the due date for making an estimated tax payment falls on a Saturday, Sunday, or legal holiday, the payment will be on time if you make it on the next day that is not a Saturday, Sunday, or legal holiday.

January payment. If you file your 1991 return by January 31, 1992, and pay the rest of the tax you owe, you are not required to make your estimated tax payment that would be due on January 15, 1992.

Fiscal year taxpayers. If your tax year does not start on January 1, your payment due dates are:

The 15th day of the 4th month of your fiscal year,

The 15th day of the 6th month of your fiscal year,

The 15th day of the 9th month of your fiscal year, and

The 15th day of the 1st month after the end of your fiscal year.

You do not have to make the last payment listed above if you file your income tax return by the last day of the first month after the end of your fiscal year and pay all the tax you owe with your return.

When to Start

You do not have to make estimated tax payments until you have income on which you will owe the tax. If you have income subject to estimated tax during the first payment period, you must make your first payment by the due date for the first payment period. You can pay all your estimated tax at that time, or you can pay it in four installments, the first by the due date for the first payment period and the remaining installments by the due dates for the later periods.

If you first have income subject to estimated tax during a later payment period, you must make your first payment by the due date for that period. You can pay your entire estimated tax by the due date for that period, or you can pay it in installments by the due date for that period and the due dates for the remaining periods. This is illustrated in the following chart:

If you first have income on which you must pay estimated tax:	Make a payment by:	Make later installments by:
On or before March 31	April 15	June 15 September 15 January 15 next year*
After March 31 and before June 1	June 15	September 15 January 15 next year*

After May 31 and before Sept. 1	September 15	January 15 next year*
After August 31	January 15 next year*	(Not applicable)

*See *January payment*, under *When to Pay Estimated Tax*, earlier.

After making your first estimated tax payment, changes in your income, deductions, credits, or exemptions may make it necessary for you to refigure your estimated tax. Pay the unpaid balance of your amended estimated tax by the next payment due date after the change or in installments by that date and the due dates for the remaining payment periods.

To determine how much you should pay by each payment due date, see *How to Figure Each Payment*, later.

Farmers and Fishermen

If you received at least two-thirds of your gross income for 1990 from farming or fishing or you expect to receive at least two-thirds of your 1991 gross income from farming or fishing, you have only one payment due date for your 1991 estimated tax—January 15, 1992. The due dates for the first three payment periods, discussed under *When to Pay Estimated Tax*, earlier, do not apply to you.

If you file your 1991 return by March 2, 1992, and pay all the tax you owe, you are not required to pay estimated tax.

Fiscal year farmers and fishermen. If you are a farmer or fisherman, but your tax year does not start on January 1, you can either:

1) Pay all your estimated tax by the 15th day after the end of your tax year, or
2) File your return and pay all the tax you owe by the 1st day of the 3rd month after the end of your tax year.

For more information, see *Farmers and Fishermen* under *When to Pay Estimated Tax* in Chapter 2 of Publication 505.

How to Figure Each Payment

You should pay enough estimated tax by the due date of each payment period to avoid a penalty for that period. If you do not pay enough each payment period, you may be charged a penalty even if you are due a refund when you file your tax return. The penalty is discussed later under *Underpayment Penalty*.

Regular Method

If you must pay estimated tax beginning with the payment due April 15, 1991, and your estimated tax does not change during the year, your required estimated tax payment for each period is usually figured by dividing your total estimated tax payments (line 16 of the Estimated Tax Worksheet) by 4. (Under certain circumstances, your required payment may be less. See *Annualized Income Installment Method*, later.)

Amended estimated tax. If you refigure your estimated tax during the year, or if your first estimated tax payment is due after April 15, 1991, figure your required estimated tax payment for each remaining payment period using the following worksheet.

1. Amended total estimated tax payments	_____
2. Multiply line 1 by: .50 if next payment is due June 17, 1991. .75 if next payment is due September 16, 1991. 1.00 if next payment is due January 15, 1992	_____
3. Estimated tax payments for all previous periods	_____
4. **Next required payment:** Subtract line 3 from line 2 and enter the result (but not less than zero) here and on line 1 of your payment-voucher for your next required payment	_____

If the payment on line 4 is due January 15, 1992, **stop here.** Otherwise, go on to line 5.

5. Add lines 3 and 4	_____
6. Subtract line 5 from line 1 and enter the result (but not less than zero)	_____
7. **Each following required payment:** If the payment on line 4 is due June 17, 1991, enter one-half of the amount on line 6 here and on line 1 of the payment-vouchers for your payments due September 16, 1991, and January 15, 1992. If the amount on line 4 is due September 16, 1991, enter the full amount on line 6 here and on line 1 of the payment-voucher for your payment due January 15, 1992	_____

Example. Early in 1991 you figure your estimated tax is $1,800. You make estimated tax payments on April 15 and June 17 of $450 each ($1,800 ÷ 4).

On July 16, you sell investment property at a gain. Your refigured estimated tax is $3,600. Your required estimated tax payment for the third payment period is $1,800, figured as follows.

1. Amended total estimated tax payments	$3,600
2. Multiply line 1 by: .50 if next payment is due June 17, 1991. .75 if next payment is due September 16, 1991. 1.00 if next payment is due January 15, 1992	2,700
3. Estimated tax payments for all previous periods	900
4. **Next required payment:** Subtract line 3 from line 2 and enter the result (but not less than zero) here and on line 1 of your payment-voucher for your next required payment	$1,800

If the payment on line 4 is due January 15, 1992, **stop here.** Otherwise, go on to line 5.

5. Add lines 3 and 4	2,700
6. Subtract line 5 from line 1 and enter the result (but not less than zero)	900
7. **Each following required payment:** If the payment on line 4 is due June 17, 1991, enter one-half of the amount on line 6 here and on line 1 of the payment-vouchers for your payments due September 16, 1991, and January 15, 1992. If the amount on line 4 is due September 16, 1991, enter the full amount on line 6 here and on line 1 of the payment-voucher for your payment due January 15, 1992	$900

If your estimated tax does not change again, your required estimated tax payment for the fourth payment period will be $900.

Note. If your estimated tax payment for a previous period is less than one-fourth of your amended estimated tax, you may be charged a penalty for underpayment of estimated tax for that period when you file your tax return. To avoid the penalty, you must show that the total of your withholding and estimated tax payment for the period was at least as much as your annualized income installment. Complete Form 2210 and the Annualized Income Installment Worksheet in its instructions, and attach the form and a copy of the worksheet to your tax return. See *Form 2210* under *Underpayment Penalty*, later, for more information.

Annualized Income Installment Method

If you do not receive your income evenly throughout the year (for example, your income from a repair shop you operate is much larger in the summer than it is during the rest of the year), your required estimated tax payment for one or more periods may be less than one fourth of your estimated tax.

To see if you can pay less for any period, complete the 1991 Annualized Estimated Tax Worksheets near the end of Publication 505.

Note. If you use the annualized income installment method, you must attach to your tax return a completed Form 2210 and Annualized Income Installment Worksheet. See *Form 2210* under *Underpayment Penalty*, later.

Estimated Tax Payments Not Required

You do not have to make estimated tax payments if your withholding in each payment period is at least one-fourth of your required annual payment or at least your required annualized income installment for that period. You also do not have to make estimated tax payments if you will pay enough through withholding to keep the amount you owe with your 1991 return under $500.

Avoiding the Penalty for Underpayment of Estimated Tax

There is a way to be sure you pay enough estimated tax to avoid the penalty for underpayment, even if you are not certain that all the amounts used to figure your estimated tax are substantially correct. Assuming you filed a 1990 return that covered a 12-month period, you will not owe the penalty if the total of your withholding and estimated tax payments for each payment period is at least one-fourth of the amount on:

Form 1040, line 54,
Form 1040A, line 27, or
Form 1040EZ, line 7.

However, as explained in *Required annual payment* under *How to Figure Estimated Tax*, earlier, you may be able to pay less than this amount and still avoid the underpayment penalty.

How to Pay Estimated Tax

There are two ways to make estimated tax payments:

1) By crediting an overpayment on your 1990 return to your 1991 estimated tax, and
2) By sending in your payment with a payment-voucher from **Form 1040-ES.**

Crediting an Overpayment

If you had an overpayment on your Form 1040 or 1040A for 1990, you can apply all of it, or any part of it, to your estimated tax for 1991. On line 65 of Form 1040, or line 31 of Form 1040A, write the amount you want credited to your estimated tax rather than refunded. The amount you have credited should be taken into account when figuring your estimated tax payments. You can use all the credited amount toward your first payment, or you can spread it out in any way you choose among any or all of your payments.

Once you have asked that an overpayment be credited to your estimated tax for the next year, you cannot have that amount refunded to you, nor can you use it in any other way.

Using the Payment-Vouchers

Each payment of estimated tax must be accompanied by a payment-voucher from Form 1040–ES. If you made estimated tax payments last year, you should receive a copy of the 1991 Form 1040–ES in the mail. It will have payment-vouchers preprinted with your name, address, and social security number. Using the preprinted vouchers will speed processing, reduce the chance of error, and help save processing costs.

If you did not pay estimated tax last year, you will have to get a copy of Form 1040–ES from the IRS. After you make your first payment, a Form 1040–ES package with preprinted vouchers will be mailed to you.

Use the addressed envelopes that came with your Form 1040–ES package, or mail your payment-vouchers to the address shown in the Form 1040–ES instructions for the place where you live. ***Do not*** use the address shown in the Form 1040 or Form 1040A instructions.

Credit for Withholding and Estimated Tax

When you file your 1990 income tax return, take credit for all the income tax withheld from your salary, wages, pensions, etc., and for the estimated tax you paid for 1990. These credits are subtracted from your tax.

If you had two or more employers and were paid wages of more than $51,300 during 1990, too much social security, railroad retirement, or Medicare tax may have been withheld from your wages. See *Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld* in Chapter 35.

Withholding

If you had income tax withheld during 1990, you should receive a statement by January 31, 1991, showing your income and the tax withheld. Depending on the source of your income, you will receive:

- Form W–2, *Wage and Tax Statement*,
- Form W–2P, *Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments*,
- Form W–2G, *Statement for Recipients of Certain Gambling Winnings*, or
- A form in the 1099 series.

Forms W–2, W–2P, and W–2G. These forms are filed with your income tax return. You should get at least two copies of each form you receive. Attach one copy to the front of your federal income tax return. The other copy is for your records. Your employer may also give you copies to file with your state and local returns.

Form W–2

Your employer should give you a Form W–2 for 1990 by January 31, 1991. You should receive a separate form from each employer you worked for.

If you stop working before the end of the year, your employer can give you your Form W–2 any time after you leave your job but no later than January 31 of the following year (or the next day that is not a Saturday, Sunday, or holiday if January 31 is a Saturday, Sunday, or holiday). If you ask for the form, your employer must give it to you within 30 days after receiving your written request or by January 31 if this 30-day period ends after January 31.

If you have not received your Form W–2 by January 31, 1991, you should ask your employer for it. If you do not receive it by February 15, call the IRS toll-free telephone number for your area. The number is listed in the Form 1040, Form 1040A, and Form 1040EZ instructions. You will be asked to give your employer's name and address and, if known, your employer's identification number.

Form W–2 shows your total pay and other compensation and the income tax and social security tax that was withheld during the year. Take credit for the withheld income tax on:

- Line 55 if you file Form 1040,
- Line 28a if you file Form 1040A, or
- Line 6 if you file Form 1040EZ.

Form W–2 is also used to report any taxable sick pay you received and any income tax withheld from your sick pay.

Form W–2P

You will receive a Form W–2P for your pension or annuity, whether or not any tax was withheld. For some types of pension payments, you will receive a Form 1099–R or Schedule K–1 of Form 1041 instead of Form W–2P.

Form W–2P shows the amount of your pension or annuity for the year, and the amount of any income tax withheld. Report the tax withheld on line 55, Form 1040, or on line 28a, Form 1040A. You cannot use Form 1040EZ if you receive pension or annuity payments. See Chapter 11 for information on how to report your pension or annuity income.

Form W–2G

If you had gambling winnings, 20% may have been withheld as income tax. If tax was withheld, the person who paid you will give you a Form W–2G showing the amount you won and the amount of tax withheld. Report the amounts you won on line 22, Form 1040. Take credit for the tax withheld on line 55, Form 1040. If you had gambling winnings, you must use Form 1040; you cannot use Form 1040A or Form 1040EZ. See *Deductions Not Subject to the 2% Limit* in Chapter 30 for information on how to deduct gambling losses.

The 1099 Series

The forms in the 1099 series are not filed with your return. Keep these forms for your records. There are several different forms in this series, including:

- Form 1099–DIV, *Statement for Recipients of Dividends and Distributions*,
- Form 1099–G, *Statement for Recipients of Certain Government Payments*,
- Form 1099–INT, *Statement for Recipients of Interest Income*,
- Form 1099–MISC, *Statement for Recipients of Miscellaneous Income*,
- Form 1099–R, *Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.*,
- Form SSA–1099, *Social Security Benefit Statement*, and
- Form RRB–1099, *Statement for Recipients of Payments by the Railroad Retirement Board*.

For some types of income reported on forms in the 1099 series, you may not be able to use Form 1040A or Form 1040EZ. See the instructions to these forms for details.

If you were subject to backup withholding on income you received during 1990, include the amount withheld, as shown on your Form 1099, in the total on line 55, Form 1040, or line 28a, Form 1040A. Check the box next to this total.

Form Not Correct

If you receive a form with incorrect information on it, you should ask for a corrected form. The corrected Form W–2G or Form 1099 you receive will be marked "CORRECTED." A special form, Form W–2c, *Statement of Corrected Income and Tax Amounts*, is used to correct a Form W–2 or W–2P.

Form Received After Filing

If, after you file your return, you receive a form for income that you did not include on your return, you should report the income and take credit for any income tax withheld by filing Form 1040X, *Amended U.S. Individual Income Tax Return*. See *Amended Returns and Claims for Refund* in Chapter 1.

Separate Returns

If you are married, but file a separate return, you can take credit only for the tax withheld from your own income. Do not include any amount withheld from your spouse's income. However, different rules may apply if you live in a community property state.

Community property states. If you live in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin, and file a separate return, you and your spouse must each report half of all community income in addition to your own separate income. Each of you takes credit for half of all taxes withheld on the community income. If you were divorced during the year, each of you generally must report half the community income and can take credit for half the withholding on that community income for the period before the divorce.

For more information on these rules, and some exceptions, see Publication 555, *Federal Tax Information on Community Property*.

Fiscal Years

If you file your tax returns on the basis of a fiscal year (a 12-month period ending on the last day of any month except December), you must follow special rules to determine your credit for withheld income tax.

During your fiscal year, one calendar year will end and another will begin. You can claim credit on your tax return only for the tax withheld during the calendar year ending in your fiscal year. You cannot claim credit for any of

the tax withheld during the calendar year beginning in your fiscal year.

However, if income tax has been withheld from your income under the backup withholding rule, take credit for it on your tax return for the fiscal year in which you received the payment.

For a more detailed discussion of how to take credit for withholding on a fiscal year return, see *Fiscal Years* under *Withholding* in Chapter 3 of Publication 505.

Estimated Tax

Take credit for all your estimated tax payments for 1990 on line 56 of Form 1040 or line 28b of Form 1040A. Include any overpayment from 1989 that you had credited to your 1990 estimated tax. You must use Form 1040 or Form 1040A if you paid estimated tax. You cannot use Form 1040EZ.

Name changed. If you changed your name, and you made estimated tax payments using your old name, attach a brief statement to the front of your tax return indicating:

1) When you made the payments,
2) The amount of each payment,
3) Which address you sent the payments to, and
4) Your name when you made the payments and your social security number.

The statement should cover payments you made jointly with your spouse as well as any you made separately.

Separate Returns

If you and your spouse made separate estimated tax payments for 1990 and you file separate returns, you can take credit only for your own payments.

If you made joint estimated tax payments, you must decide how to divide the payments between your returns. One of you can claim all of the estimated tax paid and the other none, or you can divide it in any other way you agree on. If you cannot agree, you must divide the payments in proportion to each spouse's individual tax as shown on your separate returns for 1990.

Divorced Taxpayers

If you made joint estimated tax payments for 1990, and you were divorced during the year, either you or your former spouse can claim all of the joint payments, or you each can claim part of them. If you cannot agree on how to divide the payments, you must divide them in proportion to each spouse's individual tax as shown on your separate returns for 1990.

If you claim any of the joint payments on your tax return, enter your former spouse's social security number in the space provided on the front of Form 1040 or Form 1040A. But if you remarried in 1990, enter your present spouse's social security number in that space and write your former spouse's social security number, followed by "DIV," to the left of line 56, Form 1040, or line 28b, Form 1040A.

Underpayment Penalty

If you did not pay enough tax either through withholding or by making estimated tax payments, you will have an underpayment of estimated tax and you may have to pay a penalty. However, you will *not* generally have to pay a penalty for 1990 if any of the following situations applies to you.

- The total of your withholding and estimated tax payments was at least as much as your 1989 tax, and all required estimated tax payments were on time.
- The tax balance on your return is no more than than 10% of your total 1990 tax, and all required estimated tax payments were on time.
- Your total 1990 tax minus your withholding is less than $500.
- You did not owe tax for 1989.

Special rules apply if you are a farmer or fisherman. See *Farmers and Fishermen* in Chapter 4 of Publication 505 for more information.

General Rule

In general, you may owe a penalty for 1990 if you did not pay at least the ***smaller*** of:

1) 90% of your 1990 tax, or
2) 100% of your 1989 tax (assuming your 1989 return covered a 12-month period).

The penalty is figured separately for each payment period, so you may owe a penalty for an earlier payment period even if you later paid enough to make up the underpayment. If you did not pay enough tax by the due date of each of the payment periods, you may owe a penalty even if you are due a refund when you file your income tax return.

Example. You did not make estimated tax payments during 1990 because you thought you had enough tax withheld from your wages. Early in January 1991 you made an estimate of your total 1990 tax and realized that your withholding was $2,000 less than the amount needed to avoid a penalty for underpayment of estimated tax.

On January 11 you made an estimated tax payment of $3,000, the difference between your withholding and your estimate of your total tax. Your final return shows your total tax to be $50 less than you originally figured, so you are due a refund.

You do not owe a penalty for your payment due January 15, 1991, but you will owe a penalty through January 11 for your underpayments for the earlier payment periods.

Minimum required each period. You will owe a penalty for any 1990 payment period for which your estimated tax payment plus your withholding for the period and overpayments for previous periods was less than the ***smaller*** of:

1) 22.5% of your 1990 tax, or
2) 25% of your 1989 tax (assuming your 1989 return covered a 12-month period).

Change from 1989 joint return or separate return. If you file a joint return with your spouse for 1990, but you filed separate returns for 1989, your 1989 tax is the total of the tax shown on your separate returns.

If you file a separate return for 1990, but you filed a joint return with your spouse for 1989, your 1989 tax is your share of the tax on the joint return. To figure your share, first figure the tax both you and your spouse would have paid had you filed separate returns for 1989. Then multiply your joint tax liability by the following fraction:

$$\frac{\text{Your separate tax liability}}{\text{Both spouses' separate tax liabilities}}$$

Example. Lisa and Chris filed a joint return for 1989 showing taxable income of $48,000 and a tax of $9,424. Of the $48,000 taxable income, $40,000 was attributable to Lisa and $8,000 was attributable to Chris. Lisa figures her share of the tax on the joint return as follows:

Tax on $40,000 based on a separate return	$ 9,325
Tax on $8,000 based on a separate return	1,204
Total	$10,529
Lisa's portion of total ($9,325 ÷ $10,529)	89%
Lisa's share of joint return tax ($9,424 × 89%)	$ 8,387

IRS can figure the penalty for you. If you do not want to figure your penalty and pay it when you file your tax return, you do not have to. The IRS will figure it for you and send you a bill. However, in certain situations you must complete Form 2210 or Form 2210F and attach it to your return. See the following discussions.

Form 2210. If you want to figure your penalty, complete Part I and either Part II or Part III of Form 2210, *Underpayment of Estimated Tax by Individuals and Fiduciaries.* Attach it to your Form 1040 or Form 1040A. (If you attach Form 2210 to your return, you cannot file Form 1040EZ.)

On Form 1040, enter the amount of your penalty on line 67. If you owe tax on line 66, add the penalty to your tax due and show your total payment on line 66. If you are due a refund, subtract the penalty from the overpayment you show on line 63.

On Form 1040A, enter the amount of your penalty on line 33. If you owe tax on line 32, add the penalty to your tax due and show your total payment on line 32. If you are due a refund, subtract the penalty from the overpayment you show on line 29.

You ***must*** attach Form 2210 to your return if any of the following applies.

1) You use the annualized installment method.
2) You use your actual withholding for each payment period.
3) You file a separate return for 1990 and base your required payments on your share of the tax shown on a joint return filed with your spouse for 1989. (See *Change from 1989 joint return or separate return,* earlier.)
4) You claim a waiver. (See *Waiver of Penalty,* later.)

For help in completing Form 2210, including illustrated examples, see Chapter 4 of Publication 505.

Annualized income installment method. If you did not receive your income evenly throughout the year (for example, your income from a repair shop you operated was much larger in the summer than it was during the rest of the year), you may be able to lower or eliminate your penalty by figuring your underpayment using the annualized installment method. Under this method, your required installment for one or more payment periods may be less than one-fourth of your required annual payment.

To figure your underpayment using this method, complete the Annualized Income Installment Worksheet in the Form 2210 instructions and check the box on line 20 of Form 2210. You must attach the form and a copy of the worksheet to your return and write

the letter "B" in the space next to the penalty amount on your return.

Actual withholding method. Generally, one-fourth of your withholding is treated as paid by the due date for each payment period. However, you can choose to establish how much was actually withheld on or before the due dates and use those amounts. This choice may result in a smaller penalty if most of your withholding occurred early in the year.

If you use the actual withholding method to figure your penalty, write the letter "C" in the space next to the penalty amount on your return.

Short method for figuring the penalty. Beginning in 1990, you may be able to use the short method in Part II of Form 2210 to figure your penalty for underpayment of estimated tax. If you qualify to use this method, it will result in the same penalty amount as the regular method, but with fewer computations.

You can use the short method only if you meet one of the following requirements.

1) You made no estimated tax payments for 1990. It does not matter whether you had income tax withholding.
2) You paid estimated tax on all four due dates in equal installments. You must have paid the same amount on each of the following dates:

   April 15 or 16, 1990,

   June 15, 1990,

   September 15, 16, or 17, 1990, and

   January 15, 1991.

If you do not meet either requirement, figure your penalty using the regular method in Part III, Form 2210.

Note. If you use the short method in Part II, you cannot use the annualized income installment method or the actual withholding method.

Form 2210F. If you received at least two-thirds of your 1989 or 1990 income from farming or fishing, you can figure your penalty using special rules on Form 2210F, *Underpayment of Estimated Tax by Farmers and Fishermen. See Farmers and Fishermen* in Chapter 4 of Publication 505 for more information.

Exceptions

You do not have to fill out Form 2210 or Form 2210F or pay any penalty if either of the following conditions applies.

Less Than $500 Due

You do not owe a penalty if the total tax shown on your return minus the amount you paid through withholding (including excess social security, railroad retirement, and Medicare tax withholding) is less than $500.

Total tax for 1990. For 1990, your total tax on Form 1040 is the amount on line 54 reduced by the total of the amounts on lines 51, 57, and 60, any uncollected social security or railroad retirement tax on tips included on line 54, and any tax on an IRA or a qualified retirement plan from Form 5329 (other than Part II) included on line 52.

Your total tax on Form 1040A is the amount on line 27 minus the amount on line 28c. Your total tax on Form 1040EZ is the amount on line 7.

No Tax Liability Last Year

You do not owe a penalty if you had no tax liability last year and you were a U.S. citizen or resident for the whole year. For this rule to apply, your tax year must have included all 12 months of the year.

You had no tax liability for 1989 if your total tax was zero or you were not required to file an income tax return.

Example. Ray was unemployed for most of 1989. He earned $1,700 before he was laid off, and he received $2,500 in unemployment compensation afterwards. He had no other income and did not have to pay income tax or self-employment tax. He filed a return only to have his withheld income tax refunded to him. In 1990, Ray began regular work as an independent contractor. Because Ray did not have to pay any tax for 1989, the penalty for underpaying estimated tax does not apply to him for 1990, even if he made no estimated tax payments.

Total tax for 1989. If you filed Form 1040 for 1989, your total tax is the amount on line 53 reduced by the total of the amounts on lines 51, 58, and 61, any uncollected social security or railroad retirement tax on tips included on line 53, and the tax on an IRA or a qualified retirement plan from Form 5329 (other than Part II) included on line 52.

Your total tax on Form 1040A for 1989 is the amount on line 22 minus the amount on line 25b. Your total tax on Form 1040EZ is the amount on line 7.

Waiver of Penalty

The penalty for underpayment can be waived by the IRS if either:

1) You did not make a payment because of a casualty, disaster, or other unusual circumstance, and it would be inequitable to impose the penalty, or
2) You retired (after reaching age 62) or became disabled during the tax year a payment was due or during the preceding tax year, and both the following requirements are met:
   a) You had reasonable cause for not making the payment, and
   b) Your underpayment was not due to willful neglect.

To claim either waiver, follow the procedures explained in the instructions for Form 2210 or Form 2210F, and write the letter "A" in the space next to the penalty amount on your return.

Part II
Income

The nine chapters in this part discuss many kinds of income. They explain which income is and is not taxed. Refer to the chart below for a list of some of the topics covered in this part. The chart is divided into (1) items you generally must include in income and (2) items you generally do not include in income. If you are trying to shelter any income from tax, check Chapter 14. See Part III for information on gains and losses you report on Schedule D (Form 1040).

INCOME

Generally INCLUDES:

- Wages, salaries, and other earnings (Chapter 6)
- Tips (Chapter 7)
- Interest (Chapter 8)
- Dividends (Chapter 9)
- Rental income (Chapter 10)
- Pensions and annuities (Chapter 11)
- Part of social security benefits and equivalent railroad retirement benefits (Chapter 12)
- Alimony (Chapter 13)
- Bartering income (Chapter 13)
- Cancelled debt income (Chapter 13)
- Gain on the sale of personal items such as a car (Chapter 13)
- Gambling winnings (Chapter 13)
- Income from an activity not for profit (Chapter 13)
- Recoveries of amounts previously deducted (Chapter 13)
- Royalties (Chapter 13)
- Your share of estate and trust income (Chapter 13)
- Your share of partnership or S Corporation income (Chapter 13)

Generally DOES NOT INCLUDE:

- Meals and lodging (Chapter 6)
- Housing allowance for members of the clergy (Chapter 6)
- Military allowances (Chapter 6)
- Veterans' benefits (Chapter 6)
- Interest on state and local government obligations (Chapter 8)
- Part of social security benefits and equivalent railroad retirement benefits (Chapter 12)
- Accident and health insurance proceeds (Chapter 13)
- Gifts and inheritances (Chapter 13)
- Life insurance proceeds (Chapter 13)
- Part of scholarships and fellowship grants (Chapter 13)
- Welfare and other public assistance benefits (Chapter 13)
- Workers' compensation and similar payments for sickness and injury (Chapter 13)

6. Wages, Salaries, and Other Earnings

Important Changes

Educational assistance provided by your employer. Your employer should have excluded the first $5,250 of any qualified educational assistance that your employer paid for you through September 30, 1990. This exclusion does not apply to educational assistance paid for you after September 30, 1990; your employer must include the amount in your wages on Form W-2. See *Educational assistance program* under *Other Fringe Benefits*, later. You may, however, be able to take a deduction for business education expenses. See Publication 508, *Educational Expenses*, for more information.

Group legal services plan. Your employer may have excluded up to $70 of the amount your employer paid for your coverage under a qualified group legal services plan. This exclusion is no longer available after September 30, 1990. After that date, you must include in income the value of any coverage that your employer paid on your behalf. See *Group legal services plan* under *Other Fringe Benefits*, later.

Generally, you must include in gross income everything you receive in payment for personal services. In addition to wages, salaries, commissions, tips, and fees, this includes other forms of compensation such as fringe benefits and payments for certain expenses you incur. You must report income in the form of goods or services at the fair market value of the goods or services you received.

You must keep accurate records of all your earnings that are not subject to withholding. See *Recordkeeping* in Chapter 1.

Employee Compensation

This section explains many types of employee compensation. The subjects are arranged in alphabetical order followed by *Fringe Benefits, Disability Income,* and *Pension and Annuity Contributions,* which are explained in greater detail.

Advance commissions and other earnings. If you receive advance commissions or other amounts for services to be performed in the future, and you are a cash method taxpayer, you must include these amounts in income in the year received.

If you repay unearned commissions or other amounts in the same year in which you received them, you reduce the amount to include in income by the repayment. However, if you repay the unearned commissions or other amounts in a later tax year, you can deduct the repayment as an itemized deduction on your Schedule A (Form 1040), or you may be able to take a credit for that year. See *Repayments* in Publication 525, *Taxable and Nontaxable Income.*

Back pay awards. Amounts you are awarded in a settlement or judgment for back pay, including unpaid life insurance premiums and unpaid health insurance premiums, are included in gross income. They should be reported to you by your employer on Form W–2.

Bonuses and awards paid to you for outstanding work are income shown on your Form W–2. These include prizes such as vacation trips for meeting sales goals. If a prize or award is in goods or services, you must include the fair market value of the goods or services in income. However, if your employer merely promises to pay you a bonus or award at some future time, it is not taxable until you receive it or it is made available to you. If you receive an award for length of service or safety achievement, see *Employee achievement awards* in Chapter 13.

Christmas gifts. If your employer gives you a turkey, ham, or other item of nominal value at Christmas or other holidays, the value of the gift is not income. However, if your employer gives you cash, a gift certificate, or similar item that you can easily exchange for cash, the value of the gift is extra salary or wages regardless of the amount involved.

Government cost-of-living allowances are generally not included in income of federal civilian employees, including federal court employees, stationed in Alaska, Hawaii, or outside the 48 contiguous states or the District of Columbia.

Allowances and differentials that increase your basic pay as an incentive for taking a less desirable post of duty are part of your compensation and must be included in income. For example, your compensation includes Foreign Post, Foreign Service, and Overseas Tropical salary differentials. For more information, get Publication 516, *Tax Information for U.S. Government Civilian Employees Stationed Abroad.*

Interview expenses. If an employer asks you to appear for an interview and pays you an allowance, or reimburses you for your transportation and other travel expenses, you include in income on line 22, Form 1040, only the amount you receive that is more than your actual expenses.

Moving expense allowances or reimbursements are included in your salary or wages for the tax year in which you receive them. See *How to Report* in Chapter 27.

Property purchased from employer. If your employer allows you to buy property below its fair market value as compensation for your services, you must include in income as wages the difference between the property's fair market value and the amount you paid for it.

Property received for services. If you receive property for your services, you generally must include its value in gross income as wages. Property for services includes shares of corporate stock from your employer. You must include the fair market value of this property in the year you receive it. However, you may not have to include the value of the property in income in the year received, if the property is both nontransferable and subject to a substantial risk of forfeiture. For details, see *Restricted Property Received for Services* in Publication 525.

Dividends you receive on restricted stock are extra compensation to you. Restricted stock is stock you received from your employer and did not include in income because it was nontransferable and subject to forfeiture. Your employer should include these payments on your Form W–2.

Dividends you receive on stock you chose to include in income in the year transferred are treated the same as any other dividends. Report them on line 9, Form 1040. For a discussion of dividends, see Chapter 9.

Get Publication 525 for information on how to treat dividends reported on both your Form W–2 and Form 1099–DIV.

Severance pay is taxable. A lump-sum payment for cancellation of your employment contract is income in the tax year you receive it and must be reported with your other salaries and wages.

Accrued leave payment. If you are a federal employee and receive a lump-sum payment for accrued annual leave when you retire or resign, this amount will be included on your Form W–2.

If you resign from one agency and are reemployed by another agency, you may have to repay part of your lump-sum annual leave payment to the second agency. You can reduce gross wages by the amount you repaid in the same tax year in which you received it. You should attach to your tax return a copy of the receipt or statement furnished by the agency to which repayment is made to explain the difference between the wages on the return and the wages on your Forms W–2.

Sick pay. Amounts you receive from your employer while you are sick or injured are part of your salary or wages. Report the amount you receive on line 7, Form 1040; line 7, Form 1040A; or line 1, Form 1040EZ. You must include in income payments made by:

1) Your employer.
2) A welfare fund.
3) A state sickness or disability fund.
4) An association of employers or employees.
5) An insurance company, if your employer paid for the plan.

However, if you paid the premiums on an accident or health insurance policy, the benefits you receive under the policy are not taxable.

Railroad sick pay. If you receive sick pay under the Railroad Unemployment Insurance Act, these payments are taxable and you must include them in income. However, you do not have to include them in income to the extent they are for an on-the-job injury.

If you received income because of a disability, see *Disability Income,* later.

Social security tax paid by employer. If you and your employer have an agreement that your employer pays your social security tax without deducting it from your gross wages, you must report the amount of tax paid for you as taxable wages on your tax return. You must also treat the payment as wages for figuring your social security tax and your social security benefits. However, these payments are not treated as social security wages if you are a domestic worker employed in private homes or you are an agricultural worker.

Stock appreciation rights. If your employer grants you a stock appreciation right, do not include it in income until you exercise the right. When you exercise the right, you are entitled to a cash payment equal to the amount that the fair market value of the corporation's stock on the date of exercise has increased over the fair market value on the date the right was granted. You include the cash payment in income in the year you exercise the right.

Stock options. You usually have taxable income when you receive or exercise a nonstatutory option to buy stock (or other property) as payment for your services. However, if your option is a statutory stock option—an incentive stock option or an option granted under an employee stock purchase plan—special rules generally delay the tax until you sell or exchange your shares of stock. For details, get Publication 525.

Unemployment compensation. You must include in income all unemployment compensation you receive. You may be liable for estimated tax if you receive unemployment compensation. For more information, get Publication 505, *Tax Withholding and Estimated Tax.*

Types of unemployment compensation. Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or of a state. It includes:

1) Benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund.
2) Unemployment insurance benefits.
3) Railroad unemployment compensation benefits.
4) Disability payments from a government program paid as a *substitute* for unemployment compensation (amounts received as workers' compensation for injuries or illness are *not* unemployment compensation).
5) Trade readjustment allowances under the Trade Act of 1974.
6) Benefits under the Airline Deregulation Act of 1978.

7) Unemployment assistance under the Disaster Relief Act Amendments of 1974.

If you contribute to a governmental unemployment compensation program, and your contributions are not deductible, amounts you receive under the program are not included as unemployment compensation until you recover your contributions.

Supplemental unemployment benefits received from a company-financed fund (and the employees did not contribute to the fund) are not unemployment compensation. They are taxable as wages subject to income tax withholding but not subject to social security or federal unemployment taxes.

You may have to repay some of your supplemental unemployment benefits to qualify for trade readjustment allowances under the Trade Act of 1974. If you repay supplemental unemployment benefits in the same year you receive them, reduce the total benefits by the amount you repay. However, if you repay the benefits in a later year, you must include the full amount of the benefits you received in income for the year you received them.

Deduct the repayment in the later year as an adjustment to gross income. Include the repayment on line 30, Form 1040, and put "Sub-pay TRA" and the amount on the dotted line next to line 30. If the amount you repay in a later year is more than $3,000, you may be able to take a credit against your tax for the later year instead of deducting the amount repaid. For information on this, see the discussion on *Repayments* in Publication 525.

Private unemployment fund. Unemployment benefit payments from a private fund to which you voluntarily contribute are taxable only if the amounts you receive are more than your total payments into the fund. Report the taxable amount on line 22, Form 1040.

Payments by a union. Benefits paid to you as an unemployed member of a union out of regular union dues are included in gross income on line 22, Form 1040.

Guaranteed annual wage. Payments you receive from your employer during periods of unemployment, under a union agreement that guarantees you full pay during the year, are taxable as wages.

State employees. Payments may be made by a state to its employees who are not covered by the state's unemployment compensation law. If the payments are similar to benefits under that law, they are fully taxable. Report these payments on line 22, Form 1040.

Fraudulently obtained unemployment compensation is fully taxable and is reported on line 22, Form 1040.

Repayment of unemployment compensation benefits. If you repaid in 1990 unemployment compensation benefits you received in 1990, subtract the amount you repaid from the total amount you received and enter the difference on line 20, Form 1040, or on line 12, Form 1040A. Write "Repayment" and the amount you repaid on the dotted line next to line 20 or next to line 12. If you repaid in 1990 benefits you included in income in a prior year, see *Repayments*, in Chapter 13.

Union benefits and dues. Amounts deducted from your pay for union dues, assessments, contributions, or other payments to a union cannot be excluded from your salary or wages. You must include them in income as wages.

You may be able to deduct some of these payments as a miscellaneous deduction subject to the 2% limit if they are related to your job and if you itemize your deductions on Schedule A (Form 1040). You may deduct them whether you paid them directly to the union or had them deducted from your pay. See *Union Dues and Expenses* in Chapter 30.

Strike and lockout benefits paid to you by a union from union dues, including both cash and the fair market value of other property, are usually included in income as wages. You can exclude these benefits from income only when the facts show that the union intended them as gifts to you.

Withholding. Amounts withheld from your pay for income tax, social security tax, or savings bonds are considered received by you. They will be included in your wages on Form W–2. The same generally is true of amounts withheld for taxable fringe benefits, pensions, insurance, union dues, and other assessments. For more information on withholding, get Publication 505, *Tax Withholding and Estimated Tax.*

If your employer uses your wages to pay your debts, or if your wages are attached or garnisheed, the full amount is considered received by you. Also included in your wages are fines or penalties withheld from your pay.

Fringe Benefits

The value of fringe benefits you receive from your employer is taxable and must be included in income as compensation, unless the benefits are specifically excluded by law or you pay fair market value for them.

Some benefits you must report in income include your personal use of an employer-provided car or aircraft or membership in a country club. For more information about fringe benefits, get Publication 525.

Certain fringe benefits you receive are specifically excluded by law. These include:

1) No-additional-cost service.
2) Qualified employee discount.
3) Working condition fringe benefit.
4) De minimis (minimal) fringe benefit.

No-Additional-Cost Service

If your employer provides you with a service offered for sale to customers in the ordinary course of your employer's line of business in which you work, and your employer does not incur any substantial additional cost in providing this service to you, you will not have to include in income the value of the service. Examples of no-additional-cost services are free, or reduced-price, stand-by flights for airline employees, and free telephone service to telephone company employees.

Non-excess capacity services are not eligible for exclusion as no-additional-cost services. For example, an employee's use of a stock brokerage firm to buy stock, or a mutual fund to buy an interest in the mutual fund, does not qualify. However, non-excess capacity services can be considered a qualified employee discount, discussed later.

Reciprocal agreements. You can exclude a no-additional-cost service provided by a different employer who has a written reciprocal agreement with your employer if the following conditions are met:

- The agreement states that employees of each employer who perform substantial services in the same line of business can receive no-additional-cost services from the other employer.
- The service provided to the employees is the same type provided to customers in the same line of business in which the employees perform substantial services.
- Neither employer incurs substantial additional cost in providing the service to the other's employees. If one employer pays a substantial amount to the other in connection with the agreement, that employer has incurred a substantial additional cost.

Recipient of services. The value of these no-additional-cost services will not have to be included in income if the services are offered to:

1) Any individual who is currently employed by the employer in the line of business.
2) A retired or disabled employee who was formerly employed in the line of business.
3) A surviving spouse of a current or former employee who could no longer work because of retirement or disability.
4) A spouse or dependent child of an employee (including a child whose parents have died and who has not reached age 25).
5) Any partner who performs services for the partnership.

For purposes of item (4) above, a child of divorced parents is treated as a dependent of both parents, if the child can be claimed as a dependent by either parent. In addition, any use of air transportation by the parent of an employee of an airline or airline affiliate will be treated as use by the employee. This does not include the parent of a surviving spouse of a deceased, retired, or disabled employee.

Note. If these services are generally available only to highly compensated employees, then the value of the services cannot be excluded from the income of the highly compensated employees.

Qualified Employee Discount

If your employer allows you to buy qualified property or services (defined below) at a discount (a price that is less than the price it is sold for to customers), you will not have to include in income the value of the discount if:

1) The discount you get on property is not greater than the gross profit percentage of the price at which the property is offered for sale to customers, or
2) The discount you get on services is not greater than 20% of the price at which the services are offered for sale to customers.

The value of these qualified employee discounts also will not have to be included in income if the discounts are offered to a spouse, a dependent child, a former employee (if retired or disabled), or to a surviving spouse or dependent child (if both parents are deceased, the child must be under age 25) of an employee or former employee who is retired or disabled.

For purposes of these discounts, if your employer leases space in a department store, you will be treated as an employee of the department store.

Qualified property or services generally means any property (other than real property and personal property held for investment) or services offered for sale to customers in the ordinary course of your employer's line of business in which you work.

Note. If these discounts are generally available only to highly compensated employees, the value of the discount cannot be excluded from the income of the highly compensated employees.

Working Condition Fringe

You will not have to include in income the value of property or services provided to you by your employer if you would be allowed to take a business deduction for them had you paid for them. Examples of working condition fringe benefits are the business use of a company car and subscriptions to business periodicals provided to you by your employer.

Parking. You do not have to include in income the value of free parking facilities provided to you on or near your employer's business premises.

Demonstration car. If you are a full-time car salesperson and you are provided a demonstration car to use in the sales area of your car dealer's sales office, you will not have to include in income the value of the car if:

1) The car is provided mainly so you can help your employer.
2) There are substantial restrictions on your personal use of the car.
3) The car is currently in the inventory of the automobile dealership.
4) The car is available for test drives by customers during your normal business hours.

De Minimis (Minimal) Fringe

You do not have to include in income a fringe benefit so small in value that it would be unreasonable or administratively impractical for your employer to account for it. Examples of minimal fringe benefits are occasional typing of personal letters by a company secretary, occasional personal use of your employer's copying machine, occasional parties for employees, occasional tickets to the theater or sporting events, discount transit passes not over $15 a month, and occasional supper money or taxi fares if you work overtime.

Certain eating facilities. If your employer operates an eating facility on or near the business premises for the benefit of employees, you will not have to include in income the difference between the cost of the meals and their fair market value. In order to qualify as a de minimis fringe, the yearly income from the facility must equal or be more than the cost of operating the facility, and the facility must be available to all employees and not primarily for the benefit of highly paid employees.

If the exclusion for meals at an employer-provided eating facility is not available, you must include in income the difference between the value of the meals and the amount you pay for them. However, you may be able to exclude the value of meals your employer provides to you for his convenience if certain conditions are met. See *Meals and Lodging*, later.

On-Premises Athletic Facilities

If your employer operates a gym or other athletic facility located on the business premises, you do not have to include in income the value of this fringe benefit. To qualify, substantially all the use of this facility must generally be by employees, spouses, and dependent children.

Group Life Insurance Premiums

Group-permanent life insurance premiums paid by your employer for you are ordinary income to you and must be reported as part of your wages.

Bought for employees. Payments for up to $50,000 of group-term life insurance coverage that is provided to you by your employer are not included in income. Employer payments for insurance that exceeds the first $50,000 of coverage must be included in your income.

Form W-2. The amount included in income is reported as part of your wages on Form W-2 and is shown separately on the form. If you paid any part of the cost of the insurance and the payment qualifies to reduce the amount otherwise included in income, the reduced amount would be shown on Form W-2. See *If you pay any part*, later.

Retired employees must generally include in income the cost of payments for insurance coverage in excess of $50,000. However, certain retired employees do not have to include these amounts in income. For more information, get Publication 525.

Group-term life insurance is term life insurance protection (insurance for a fixed period of time) that:

1) Provides a general death benefit that is excluded from income.
2) Is provided to a group of employees.
3) Is provided under a policy carried by the employer.
4) Provides an amount of insurance for each employee based on a formula that prevents individual selection.

If you pay any part of the cost of the insurance, your entire payment reduces, dollar for dollar, the amount your employer would otherwise include in income. However, you cannot reduce the amount to include by your payments for future year coverage, by your prepayments for coverage after retirement, or by the payments you make for insurance for which your employer's payments are not taxed to you because of the exceptions discussed below.

Permanent benefits. If your group-term life insurance policy includes permanent benefits, such as a paid-up or cash surrender value, you must include in income, as wages, the cost of the permanent benefits, reduced by the amount you pay for them. Your employer should be able to tell you the amount to include in income.

Accidental or other death benefits in policies that do not provide general death benefits (travel insurance, for example) are not included as group-term life insurance coverage.

Exceptions. You are not taxed on the cost of this insurance if any of the following apply:

1) The coverage is provided after you have retired because of disability.
2) Your employer is the beneficiary of the policy for the entire period the insurance is in force during the tax year.
3) The only beneficiary is a qualified charitable organization (defined in Chapter 25) for the entire period the insurance is in force during the tax year. You are not entitled to a deduction for a charitable contribution by naming a charitable organization as the beneficiary of your policy.

You are taxed on the entire cost of group-term life insurance protection provided by your employer through a qualified employees' trust, such as a pension trust or a qualified annuity plan.

Full-time life insurance agents who are considered employees for social security tax purposes are treated as employees in applying the provisions relating to group-term life insurance under a policy carried by their employer.

If you have only one employer and you were insured at any time during the tax year for more than $50,000 under a group-term life insurance policy, your income from this source is shown as other compensation on the Form W-2 you receive.

If two or more employers provide you group-term life insurance coverage totaling more than $50,000, you must figure how much to include in income for the cost of all coverage that is more than $50,000. You must include the cost of life insurance provided to you during the tax year, regardless of when your employers paid the premiums.

You figure the cost for each month of coverage by multiplying the number of thousands of dollars of insurance coverage, less $50,000 of insurance (both figured to the nearest tenth) by the cost from the following table. You must prorate the cost if less than a full month of coverage is involved.

COST PER $1,000 OF PROTECTION FOR ONE MONTH

Age	Cost
Under 30	6 cents
30 through 34	9 cents
35 through 39	11 cents
40 through 44	17 cents
45 through 49	29 cents
50 through 54	48 cents
55 through 59	75 cents
60 and older	$1.17

Example. You are 51 years old and work for employers A and B. Both employers provide group-term life insurance coverage for you. Your coverage with employer A is $35,000, and your coverage with employer B is $45,000. You pay premiums of $50 a year under the employer B group plan. You figure the amount to include in income as follows:

Employer A coverage (in thousands)	$ 35
Employer B coverage (in thousands)	45
Total coverage (in thousands)	$ 80
Minus: Exclusion (in thousands)	50
Excess amount (in thousands)	$ 30
Multiply by cost per $1,000 per month, age 51 (from table)	.48
Cost of excess insurance for 1 month	$ 14.40
Multiply by number of full months coverage at this cost	12
Cost of excess insurance for tax year	$172.80
Minus: Premiums you paid	50.00
Cost to include in income as wages	$122.80

For information on employer payments for group term life insurance, get Publication 535, *Business Expenses*.

Meals and Lodging

You do not include in income the value of meals and lodging provided to you and your

family by your employer at no charge if the following conditions are met:

1) Meals are:
   a) Furnished on the business premises of your employer, and
   b) Furnished for the convenience of your employer.
2) Lodging is:
   a) Furnished on the business premises of your employer,
   b) Furnished for the convenience of your employer, and
   c) You are required to accept the lodging as a condition of your employment.

Your family, for this purpose, includes only your spouse and dependents.

Lodging includes the cost of heat, electricity, gas, water, sewer service, and similar items that are needed to make the lodging habitable.

Faculty housing. If you are employed by an educational institution and you (or your spouse and dependents) are provided qualified campus lodging for use as a residence, you must include in income the excess of the fair rental value over the amount of rent you pay. Get Publication 525 for more information.

Meals. Generally, you can exclude from income the value of meals provided to you during working hours so that you can be available for emergency calls, or because your employer's business restricts you to a short meal period (30 to 45 minutes).

If you receive a cash allowance or reimbursement from your employer for meals or lodging, you generally must include the cash allowance or reimbursement in income as wages. Your employer will not withhold income tax from it, but will include it as other compensation on your Form W-2. See Chapter 28 for information on how to report reimbursements.

For more details on meals and lodging, get Publication 525.

Other Fringe Benefits

Other fringe benefits you receive may be excluded from income.

Cafeteria plans. Cafeteria plans are separate written plans that allow participants (who must be employees) to choose among two or more benefits consisting of cash and qualified benefits. A "qualified benefit" includes any benefit that is not currently taxable to the participant upon receipt (such as group-term life insurance up to $50,000, coverage under an accident or health plan, and coverage under a dependent care assistance program).

The only taxable benefit that a cafeteria plan can offer is cash. Any qualified (nontaxable) benefit can be used in a cafeteria plan, other than scholarships and fellowship grants, educational assistance programs, and the fringe benefits (other than *Meals and Lodging*) previously discussed. Nontaxable benefits include group-term life insurance that is included in gross income only because the amount of the insurance exceeds $50,000 or the insurance is on the life of the employee's spouse or children.

A participant is not considered to have received a taxable benefit from a cafeteria plan simply because the participant can choose among the benefits of the plan.

Nondiscrimination rules. A cafeteria plan cannot discriminate in favor of highly compensated participants as to eligibility to participate in the plan or as to contributions or benefits. If the plan does discriminate, highly compensated participants must include in income the value of the benefits that could have been elected.

If qualified benefits provided to key employees are more than 25% of the total of these benefits provided for all employees under the plan, key employees must include in income the value of the benefits that could have been elected.

The taxable benefits are treated as having been received or accrued in the tax year of the highly compensated participant or key employee in which the plan year ends.

Dependent care assistance. If your employer provided you with child care or disabled dependent care services to allow you to work, you can exclude (within certain limits) the amount of this benefit. The amount you can exclude is limited to the smaller of your earned income, your spouse's earned income, or $5,000 ($2,500 if you are married filing a separate return). To exclude this benefit from income (and include any amount that exceeds the limit), see *How to report*, later.

Note. Overnight camp expenses paid by your employer from a qualified plan cannot be excluded as dependent care assistance. Also, the amount you can exclude from income reduces the dollar limit on work-related expenses you can use to figure your child and dependent care credit. For more information, get Publication 503, *Child and Dependent Care Expenses.*

For purposes of the earned income limit, if your spouse is a full-time student or incapable of self-care, your spouse will be considered to have earned $200 a month if you receive care for one dependent, or $400 a month if you receive care for two or more dependents.

If your dependent is cared for at your employer's place of business, the amount you can exclude from income is based on how often you use the facility and the value of the services.

The dependent care assistance must be provided under a separate written plan of your employer that does not favor highly compensated employees and that meets other qualifications. Your employer can tell you if the plan qualifies for the exclusion.

How to report. To exclude the correct amount of dependent care benefits you received and include in income any taxable part of the benefits, complete and attach to your return the appropriate form for *Child and Dependent Care Expenses.* Attach Form 2441 to Form 1040 or Schedule 2 to Form 1040A. Do not file Form 1040EZ to report dependent care amounts.

When you complete the child and dependent care expenses form, be sure to give the dependent care provider's name, address, and identification number.

Educational assistance. You generally must include in income, as wages, any amount your employer paid for educational expenses for you.

Exception. If the educational courses are required by your employer or are job-related, and your employer either pays the expenses directly to the educational organization or reimburses you for the expenses after you make a full accounting, you may not have to include in income the amount paid by your employer.

In other cases, you may be able to deduct the expenses under the rules explained in Chapter 29. You must include in income stipends paid by your employer when you are on educational leave.

Educational assistance program. Your employer should have excluded the first $5,250 of any qualified educational assistance that your employer paid for you through September 30, 1990. This exclusion does not apply to educational assistance paid for you after September 30, 1990; your employer should include the amount in your wages on Form W-2. You may, however, be able to take a deduction for business education expenses. See Publication 508 for more information.

Note. If your employer paid for your educational assistance before October 1, 1990, and mistakenly included the amount in your income on Form W-2, deduct the amount from your income by entering it on line 4 of Form 2106, *Employee Business Expenses.*

Caution. As this publication was being prepared for print, Congress was considering a proposal that would extend the exclusion for educational assistance. For information on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes.*

Qualified tuition reductions. If you receive a qualified tuition reduction (QTR), it is not included in your income. A QTR is the amount of reduction in tuition for education (below the graduate level) furnished by an educational institution to an employee (or a person treated as an employee or certain other individuals) provided certain requirements are met. See *Qualified tuition reductions* under *Scholarships and Fellowship Grants* in Chapter 13.

Employer-provided transportation. The value of employer-provided transportation, such as a vanpool or similar shared-usage arrangement, must be included in the gross income of each employee, including the driver, who commutes in the employer-provided vehicle.

Executive health program. Amounts an employer pays for a health reconditioning and health restoring service provided to one of its executives at an off-site resort hotel or athletic club are included in the executive's compensation.

Financial counseling fees paid by a corporation for its executives are included in the executives' gross income and must be reported as part of wages. If the fees are for tax or investment counseling, they can be deducted by the executive as a miscellaneous deduction subject to the 2%-of-adjusted-gross-income limit on Schedule A (Form 1040).

Group legal services plan. Your employer may have excluded up to $70 of the amount that your employer paid for your coverage under a qualified group legal services plan. This exclusion is no longer available after September 30, 1990. After that date, the value of any coverage that your employer paid for on your behalf must be included in your income.

Caution. As this publication was being prepared for print, Congress was considering a proposal that would extend the exclusion for group legal services coverage. For information

on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes.*

Medical insurance premiums paid for you, your spouse, and your dependents by your employer (former employer if you are retired) under an accident or health plan are not included in your income. This includes supplemental medical insurance (Medicare). You continue to be an employee during a layoff period for purposes of this benefit.

If your employer reimburses you for health insurance premiums after you verify you paid the premiums, the reimbursement is not included in income. Premiums paid by an employer for the benefit of a deceased employee's surviving spouse and dependents are also not included in income.

How To Report Fringe Benefits

The amount of your taxable fringe benefits is shown on your Form W–2.

Employer-provided car. If your employer provides a car (or other highway motor vehicle) to you, your personal use of the car is a taxable noncash fringe benefit.

Your employer must determine the actual value of this fringe benefit to include in income. Your employer determines this value by either of the following methods:

1) The actual value of your personal use of the car, or
2) The actual value of the car as if you used it entirely for personal purposes (100% income inclusion).

If your employer includes 100% of the value in your income, you may deduct the value of your business use of the car as long as you itemize your deductions. You figure the value of this business use on Form 2106, *Employee Business Expenses.* For more information, get Publication 917, *Business Use of a Car.*

Accounting period. You must use the same accounting period your employer uses to report your taxable fringe benefits. Your employer has the option to report taxable fringe benefits by either of the following rules:

1) The general rule: value the benefit for a full calendar year (January 1–December 31), or
2) The special accounting period rule: treat the value of benefits provided during the last two months of the calendar year (or any shorter period) as paid during the following calendar year.
   a) Under this rule, each year your employer includes the value of benefits provided the last 2 months of the prior year and the first 10 months of the current year.
   b) If your employer uses this rule to determine the amount to include in income, you must use the same accounting period to claim an employee business deduction (for use of a car, for example).

Your employer does not have to use the same accounting period for each fringe benefit, but is required to use the same period for all employees who receive a particular benefit. For more information, get Publication 917 and Publication 535.

Form W–2. Your employer reports your taxable fringe benefits in Box 10 (Wages, tips, other compensation) and, if applicable, Box 12 (Social security wages) of Form W–2, *Wage and Tax Statement.* The total value of your fringe benefits should also be shown in Box 16. The value of your fringe benefits may be added to your other compensation on one Form W–2, or you may receive a separate Form W–2 showing just the value of your fringe benefits in Box 10 with a notation in Box 16.

Disability Income

Generally, if you retire on disability you must report your pension or annuity as income. There is a tax credit for people who are permanently and totally disabled. For information on this credit and the definition of permanent and total disability, see Chapter 34.

Disability pensions. Generally, you must report as income any amount you receive for your disability through an accident or health insurance plan paid for by your employer. If both you and your employer pay for the plan, only the amount you receive for your disability that is due to your employer's payments is reported as income. However, certain payments may not be taxable. Your employer should be able to give you specific details about your pension plan and tell you the amount you paid for your disability pension. In addition to disability pensions and annuities, you may be receiving other payments for sickness and injury. See *Other Sickness and Injury Benefits* in Chapter 13.

If you pay the entire cost of a health or accident insurance plan, do not include any amounts you receive for your disability as income on your tax return. If your plan reimbursed you for medical expenses you deducted in an earlier year, you may have to include some, or all, of the reimbursement in income. See *Reimbursement in a later year* in Chapter 22.

Accrued leave payment. If you retire on disability, any lump-sum payment you receive for accrued annual leave is a salary payment. The payment is not a disability payment. You must report it as wages in the tax year you receive it.

Retirement and profit-sharing plans. Any payments you receive from a retirement or profit-sharing plan that does not provide for disability retirement are not payments from an accident or health plan. Therefore, do not report them as disability income. The payments are taxable and should be reported as a pension or annuity. See *Disability Income* in Chapter 11.

Military disability pensions. Generally, you must report these disability pensions as income. But certain military and government disability pensions are not taxable. For more information, see *Military and Certain Government Disability Pensions* in Chapter 11.

How to report. If you retired on disability, payments you receive are taxable as wages until you reach minimum retirement age. Minimum retirement age generally is the earliest age at which you can receive a pension or annuity, whether or not you are disabled. You must report your taxable disability payments on line 7, Form 1040, or on line 7, Form 1040A, until you reach minimum retirement age.

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension. Report the payments on line 17, Form 1040, or on line 11, Form 1040A. The rules for reporting pensions are explained in *How to Report* in Chapter 11.

Pension and Annuity Contributions

Generally, you cannot exclude from income amounts you pay into a pension plan through payroll deductions.

Contributions to Federal Thrift Savings Fund. Federal employees can choose to make contributions, from their salaries, to the Federal Thrift Savings Fund. Contributions are not included in income. Your salary of record before contributions are taken out is used for purposes of social security taxes and benefits. Payments from the fund are taxable as a distribution from a qualified pension or annuity plan.

Employer's contributions to qualified plan. Generally, your employer's contributions to a qualified pension plan for you are not included in income at the time contributed. However, employer contributions that are made out of funds that would otherwise have been paid to you as salary, except that you entered into a salary reduction agreement with your employer (elective deferral), are excluded from income only up to a limit.

For 1990 you cannot set aside more than a total of $7,979 for all elective deferrals. If you set aside more than $7,979, the excess is included in gross income that year. Contributions to tax-sheltered annuities are subject to a higher limit. Get Publication 571, *Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations.*

The cost of life insurance coverage included in an employer's plan may be income if the proceeds of the policy are payable directly or indirectly to your beneficiary. See *Group Life Insurance Premiums*, earlier, under *Fringe Benefits.*

Amounts actually distributed or made available to you generally are taxable, unless they are eligible for tax-free rollover and are rolled over (normally, within 60 days after receipt) to another qualified plan or to an individual retirement account or annuity. Your employer can tell you how the amount you received is taxed. See Chapters 11 and 19.

Employer's contributions to nonqualified plan. If your employer pays into a nonqualified plan for you, you generally must include the contributions in income as wages for the tax year in which the contributions are made. However, if your interest is not transferable and is subject to a substantial risk of forfeiture, you need not include the amount of the contribution or premium in income. When your interest becomes transferable or is no longer subject to a substantial risk of forfeiture, you must include the value in income.

Railroad retirement annuities. If you received railroad retirement tier 1 benefits greater than the "social security equivalent benefit," or tier 2 or vested dual benefits, these payments are treated as pension or annuity income and are taxable under the rules explained in Chapter 11.

Special Rules for Certain Employees

This section deals with special rules for people in certain types of employment: members of the clergy, people working for foreign employers, military personnel, veterans, ACTION and Peace Corps volunteers, and statutory employees.

Clergy

If you are a member of the clergy, you must include in income offerings and fees you receive for marriages, baptisms, funerals, masses, etc., in addition to your salary. If the offering is made to the religious institution, it is not taxable to you.

If you are a member of a religious organization and turn over your outside earnings to the organization, you still must include the earnings in income. However, you may be entitled to a charitable contribution deduction for the amount paid to the organization.

Rental value of a home. You do not have to include in income the rental value of a home (or utility expenses) provided to you as part of your pay for your duties as an ordained, licensed, or commissioned minister. However, you must include the rental value of the home, and related allowances, as earnings from self-employment on Schedule SE (Form 1040) for purposes of the social security self-employment tax.

A housing allowance paid to you as part of your salary is not income to the extent you use it, in the year received, to provide a home or to pay utilities for a home with which you are provided. The amount of the housing allowance that you can exclude from income cannot be more than the reasonable compensation for your services as a minister. The church or organization that employs you must officially designate the payment as a housing allowance before the payment is made. A definite amount must be designated; the amount of the housing allowance cannot be determined at a later date.

If you are employed and paid by a local congregation, a resolution by a national church agency of your denomination does not effectively designate a housing allowance for you. The local congregation must officially designate the part of your salary that is to be a housing allowance. However, a resolution of a national church agency can designate your housing allowance if you are directly employed by the agency. If no part has been officially designated, you must include your total salary in income.

Expenses of providing a home include rent, house payments, furniture payments, costs for a garage, and utilities. They do not include the cost of food or servants.

If you own your home, or are buying it, you can exclude your housing allowance from income if you spend it for the down payment on the home, for mortgage payments, or for interest, taxes, utilities, repairs, etc. However, you cannot exclude more than the fair rental value of the home plus the cost of utilities, even if a larger amount is designated as a housing allowance. Fair rental value of a home includes the fair rental value of furnishings in it.

You can deduct the mortgage interest and real estate taxes you pay on your home even if you use nontaxable housing allowance funds to make the payments. See Chapters 23 and 24.

Teachers or administrators. If you are a minister employed as a teacher or administrator by a church school, college, or university, you are, for purposes of the housing exclusion, performing ministerial services. However, if you perform services as the head of a religious department, or as a teacher or administrator on the faculty of a nonchurch college, and if your specific duties involve no religious functions, you cannot exclude from income a housing allowance or the value of a home that is provided to you. However, if you live in qualified campus housing as an employee of an educational institution, you do not have to include the value of that housing in income if you pay rent equal to or greater than the fair rental value of the housing.

If you serve as a "minister of music" or "minister of education," or serve in an administrative or other function of your religious organization, but are not authorized to perform all of the religious duties of an ordained minister in your church, even though you are commissioned as a "minister of the gospel," you cannot exclude from income a housing allowance or the value of a home provided to you.

Theological students. You cannot exclude a housing allowance from income if you are a theological student serving a required internship as an assistant pastor, unless you are ordained, commissioned, or licensed as a minister.

Traveling evangelists. You can exclude amounts received from out-of-town churches for evangelistic services if you are an ordained minister, if those amounts are designated as housing allowance, and you actually use them to maintain your permanent home.

Retired members of the clergy. The rental value of a home provided rent-free by your church for your past services is not income if you are a retired minister. In addition, a housing allowance paid to you is not income to the extent you spend it for utilities, maintenance, repairs, and similar expenses directly related to providing a home.

The general convention of a national religious denomination can designate a housing allowance for retired ministers, if the local congregations authorize the general convention to establish and maintain a unified pension system for all retired clergy members of the denomination for their past services to the local churches.

A surviving spouse of a retired minister cannot exclude a housing allowance from income. It must be reported on line 17 of Form 1040 or on line 11 of Form 1040A.

A pension or retirement pay for a member of the clergy is usually treated as any other pension or annuity. (See Chapter 11.) If you are not expected to perform any further services, payments from the congregation may be gifts. They are not taxable if they are based solely on your financial needs and the financial capacity of the congregation. If these payments are made under a legal agreement, an established plan, or because of past practice, they do not qualify as nontaxable gifts.

Members of religious orders. If you are a member of a religious order who has taken a vow of poverty, the amounts you earn for services you perform which you renounce and turn over to the order may or may not be included in your income. If you are performing the services as an agent of the order in the exercise of duties required by the order, you do not include in income the amounts turned over to the order.

Services performed for the order. If your order directs you to perform services for another agency of the supervising church or an associated institution, you are considered to be performing the services as an agent of the order. Any wages you earn as an agent of an order which you turn over to the order are not included in your gross income.

Example. You are a member of a church order and have taken a vow of poverty. You renounce any claims to your earnings and turn over to the order any salaries or wages you earn. You are a registered nurse, so your order assigns you to work in a hospital that is an associated institution of the church. However, you remain under the general direction and control of the order. You are considered to be an agent of the order and, therefore, any wages you earn at the hospital which you turn over to your order are not included in gross income.

Services performed outside the order. If you are directed to take employment outside the order, the employment will not constitute the exercise of duties required by the order unless the services you perform meet both of the following requirements:

1) The services are the kind that are ordinarily the duties of members of the order, and
2) The services are part of the duties that are required to be exercised for, or on behalf of, the religious order as its agent.

If the legal relationship of employer and employee exists between you and a third party, the services you perform for the third party will not be considered directed or required of you by the order. Amounts you receive for these services are included in your gross income, even if you have taken a vow of poverty.

Example. Mark Brown is a member of a religious order and has taken a vow of poverty. All claims to his earnings are renounced and the earnings belong to the order.

Mark is a school teacher. He was instructed by the superiors of the order to get a job with a private tax-exempt school. Mark became an employee of the school, and, at his request, the school made the salary payments directly to the order.

Because Mark is an employee of the school, he is performing services for the school rather than as an agent of the order. Therefore, the wages Mark earns working for the school are included in his gross income.

Foreign Employer

Special rules apply if you work for a foreign employer.

U.S. citizen. If you are a U.S. citizen who works for a foreign government, an international organization, a foreign embassy, or any foreign employer, you must include your salary in income.

Social security tax. You are exempt from social security employee tax if you are employed in the United States by an international organization or a foreign government. However, you must pay social security self-employment tax on your earnings from services performed in the United States, even though you are not self-employed. This rule also applies if you are an employee of a qualifying wholly-owned instrumentality of a foreign government.

Non-U.S. citizen. If you are not a U.S. citizen, or if you are a U.S. citizen but also a citizen of the Philippines, and you work for an international organization in the United States, your salary from that source is exempt from tax. If you work for a foreign government in the United States, your salary from that source is

exempt from tax if your work is like the work done by an employee of the United States in that foreign country and if the foreign government gives an equal exemption for the salary of the U.S. employee.

Alien status. If you are an alien and give up your right to this exemption (by filing a waiver under section 247(b) of the Immigration and Nationality Act to keep your immigrant status), you are not entitled to the exemption from the date you give it up, unless you get the exemption from a treaty, consular agreement, or international agreement.

Pensions. This exemption applies only to employees' wages, salaries, and fees. Pensions received by former employees living in this country do not qualify for this exemption.

Employment abroad. For information on income earned abroad, get Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.*

Military

Payments you receive as a member of a military service generally are taxable except for certain allowances. Report them as wages.

Taxable Income

Taxable income includes the following items.

Wages. Military pay taxable as wages includes:

- Active duty pay
- Reserve training pay
- Reenlistment bonus
- Armed services academy pay
- Amounts received by retired personnel serving as instructors in junior ROTC programs
- Lump-sum payments upon separation or release from active duty
- Student loan repayments from the General Educational Loan Repayment Program

Military retirement pay based on age or length of service is taxable and must be included on line 17, Form 1040, or on line 11, Form 1040A.

Nontaxable Income

Qualified military benefits you receive are not taxable.

- Annual round trip for dependent students
- Burial and death services (interment allowances)
- Combat zone compensation and combat-related benefits
- Death gratuities
- Defense counseling
- Dental care for military dependents
- Dependent education
- Disability benefits
- Educational assistance
- Emergency assistance
- Evacuation allowances
- Family counseling
- Family separation allowances
- Group-term life insurance
- Housing allowances
- Medical benefits
- Moving and storage
- Mustering-out payments (payments on discharge)
- Overseas cost-of-living allowances
- Premiums for survivor and retirement protection plans
- Professional education
- Quarters allowances
- Subsistence allowances
- Temporary lodging in conjunction with certain orders
- Travel for consecutive overseas tours
- Travel for consecutive overseas tours for dependents
- Travel in lieu of moving dependents during ship overhaul or inactivation
- Travel of dependents to a burial site
- Travel to a designated place in conjunction with reassignment in a dependent-restricted status
- Uniform allowance

Note. Personal use of a vehicle cannot be excluded from income as a qualified military benefit.

Veterans

Benefits paid under any law administered by the Department of Veterans Affairs (VA) are not included in gross income. The following amounts paid to veterans or their families are not taxable:

- Education, training, or subsistence allowances
- Disability compensation and pension payments for disabilities
- Grants for homes designed for wheelchair living
- Grants for motor vehicles for veterans who lost their sight or the use of their limbs
- Veterans' pensions paid either to the veterans or to their families

Veterans' insurance proceeds and dividends are not taxable either to the veterans or to their beneficiaries. This is also true of the proceeds of a veteran's endowment policy paid before death.

Interest on dividends you leave on deposit with the VA is taxable. The amount of this interest is shown on the statement the VA gives you. If you decide to use accumulated dividends to buy additional paid-up National Service Life Insurance, neither the dividends nor the paid-up insurance is taxable.

Rehabilitative program payments. VA payments to hospital patients and resident veterans for their services under the VA's therapeutic or rehabilitative program are included as income other than wages on line 22, Form 1040.

Volunteers

The tax treatment of amounts you receive as a volunteer worker for the Peace Corps, ACTION, or similar agency is covered in the following discussions.

Peace Corps

If you are a Peace Corps volunteer or volunteer leader, some amounts you receive may be exempt from tax.

Taxable allowances must be included in your income and reported as wages. These include:

- Cash allowances received during training
- Allowance paid to your spouse and minor children while you are training in the United States
- The part of living allowances designated by the President, under the Peace Corps Act, as basic compensation
- Allowances for personal items such as domestic help, laundry and clothing maintenance, entertainment and recreation, transportation, and other miscellaneous expenses
- Leave allowances
- Readjustment allowances or "termination payments." These are considered received by you when credited to your account.

Example. Gary Carpenter, a Peace Corps volunteer, gets $175 a month during his period of service, to be paid to him in a lump sum at the end of his tour of duty. Although the allowance is not available to him until the end of his service, Gary must include it in his income on a monthly basis as it is credited to his account.

Nontaxable allowances include travel and living allowances for basic necessities, such as housing, utilities, food, clothing, and household supplies.

ACTION

ACTION participants perform services in antipoverty programs and Older American volunteer programs. Some amounts these participants receive are taxable and others are exempt from tax.

VISTA. If you are a VISTA volunteer, you must include meals and lodging allowances paid to you in income as wages.

University Year for Action program. If you receive a stipend as a full-time student for service in the University Year for Action program, you must include the stipend in income as wages.

Older American programs. Do not include in income amounts you receive for supportive services or reimbursements for out-of-pocket expenses from:

- Retired Senior Volunteer Program (RSVP)
- Foster Grandparent Program
- Senior Companion Program

Other Volunteer Programs

If you receive amounts for supportive services or are reimbursed for out-of-pocket expenses under any of the following volunteer programs, you do not include these amounts in gross income:

- Service Corps of Retired Executives (SCORE)
- Active Corps of Executives (ACE)

Volunteer tax counseling. You do not include in income any reimbursements you receive for transportation, meals, and other expenses you have in training for, or actually providing, volunteer federal income tax counseling for the elderly (TCE).

You can deduct as a charitable contribution your unreimbursed out-of-pocket expenses in taking part in the volunteer income tax assistance (VITA) program.

Statutory Employees

Statutory employees are considered self-employed independent contractors for purposes of reporting income and expenses on their tax returns. If you are a statutory employee, get Publication 525, *Taxable and Nontaxable Income*, and Publication 937, *Business Reporting*, for more information.

7. Income from Tips

This chapter can help you understand how to report your tip income on your income tax return. Although this chapter focuses on tipped employees of food and beverage establishments, the recordkeeping rules and other information may also apply to other tipped employees such as hairdressers, cab drivers, and casino dealers.

All tips you receive are taxable income and are subject to federal income tax. You must include in gross income all tips you receive directly from customers, tips from charge customers that are paid to you by your employer, and your share of any tips you receive under a tip-splitting arrangement.

In addition, cash tips of $20 or more that you receive in a month while working for any one employer are subject to withholding of income tax and social security or railroad retirement tax. Report the tips you receive to your employer so that the correct amount of income and social security or railroad retirement tax can be determined. Withholding of income tax from tips is discussed in Chapter 5.

Your tips and other pay are used to determine the amount of social security or railroad retirement benefits you or your family may receive if you retire, become disabled, or die. You can get information about these benefits from Social Security offices or Railroad Retirement Board offices. Noncash tips are not counted as wages for social security purposes.

To ensure that your future benefits are figured correctly and that you have received credit for all your earnings, you should request a statement of your earnings from the Social Security Administration periodically.

Every large food or beverage establishment must report to the Internal Revenue Service (IRS) any tips allocated to its employees. Generally, tips must be allocated to employees when the total tips reported to an employer by employees are less than 8% of the establishment's food and beverage sales. See *Tip Allocation*, later.

Reporting Tips

You must report all tips as wages on Form 1040, Form 1040EZ, or Form 1040A, including the value of tips not paid in cash, such as passes, tickets, goods, or services. However, if you received tips of $20 or more in a month and you did not report all of them to your employer, you must file Form 1040.

Service charges. A club, hotel, or restaurant may require customers who use its dining or banquet rooms to pay a service charge, which is given to the waiters or waitresses and other employees. Your share of this service charge is not a tip, but is part of your wages paid by the employer. You should not include your share in your report of tips to your employer. Your employer should not include your share of the service charge in tips paid to you, but should include it in your wages.

Daily Record of Tips

You must keep a ***daily record*** or ***other evidence*** to prove the amount of tip income you report on your return.

Daily record. Your daily record must show your name and address, your employer's name, and the establishment's name. It must also show, for each workday, the amount of cash and charge tips you received directly from customers or from other employees, the amount of tips you paid out to other employees through tip sharing, etc., and the names of the other employees to whom you paid out tips.

Make the entries in your daily record on or near the date you receive the tip income.

You can use **Form 4070–A,** *Employee's Daily Record of Tips,* to keep this record.

Other evidence. If you do not keep a daily record of tips, you must maintain other evidence of the tip income you receive. This other evidence must be as credible and reliable as a daily record. This other evidence can be documentary evidence that shows tips added to a check and paid over to you or amounts paid for food or beverages on which you would generally receive a tip. Examples of documentary evidence are copies of restaurant bills, credit card charges, or charges under any other arrangement containing amounts added by customers as tips.

Your personal records. You should keep your daily tip record and a copy of the written reports you give your employer with your personal records.

When to Report Tips to Employer

You must give your employer a written report of your tips for each month by **the 10th day** of the next month. This report is required for each month that you receive tips of $20 or more while working for that employer.

Saturday, Sunday, holiday rule. If the 10th day of the month falls on a Saturday, Sunday, or legal holiday, you may give your employer the report on the next day that is not a Saturday, Sunday, or legal holiday.

Example. You must report tips of $20 or more you receive during January 1991 to your employer by Monday, February 11, 1991.

How to Report Tips to Employer

The following discussions refer only to tips paid by cash, charge, and check.

Less than $20 in tips in one month. If you receive less than $20 in tips while working for one employer during a month, you do not have to report them to that employer. But you must include the tips in gross income on your income tax return. You do not have to pay social security or railroad retirement tax on these tips.

$20 or more of tips in one month. If you receive tips of $20 or more in a month while working for any one employer, you must report the total amount of your tips to that employer by the 10th day of the next month.

Example 1. You work for Watson's Restaurant during the month and receive $75 in tips. Because your tips are more than $20 for the month, you must report the $75 to your employer.

Example 2. You work for Watson's Restaurant during the month and receive $17 in tips. In that same month you work for Parkview Restaurant and get $14 in tips. Even though your tips total $31, you do not have to report them to either employer because you received less than $20 in tips from each job. However, you should keep a record of the $31 because you must report it as income on your tax return.

Tip splitting. If you split tips with fellow employees, such as waiters giving a part of their tips to busboys, include only your share of the tips in your report to your employer. "Tip splitting" may also be referred to as "tip sharing" or "tip pooling."

Your tip report to your employer should cover only one calendar month. But, your employer may require you to report your tips more often than once a month. For example, you may be required to report your tips weekly. In this case, you must make your report on the dates set by your employer.

When you stop working for your employer, you should report your tips of $20 or more to your employer at that time. If you do not report the tips when you stop working, you must give a statement to your employer either before your final payday or by the 10th day following the month you receive the tips, whichever is earlier.

Your tips are treated as paid to you when you make your written report to your employer. However, if you make no report to your employer, your tips are treated as paid to you when you receive them.

Example 1. During December 1990, you received $300 in tips. On January 10, 1991, you reported the tips to your employer. Your December 1990 tips will be treated as paid to you in January 1991, at the time you made the report to your employer. You must report the $300 on your 1991 income tax return.

Example 2. If during December 1990 your tips were only $18, you would not have to make a report to your employer. In this case your tips are treated as paid in December 1990, the time you actually received them. You must report the $18 on your 1990 income tax return.

To report tips to your employer, you may use **Form 4070,** *Employee's Report of Tips to Employer.* This form, available in Publication 1244, tells you what information you must report. If you do not use Form 4070, your report should include the amount of the tips, your employer's name and address, your name and address, your social security number, the month (or shorter period) covered, your signature, and the date of the report.

Publication 1244 is a booklet containing several copies of both Form 4070 and Form 4070–A for your use.

Withholding on Tips by Employer

Your employer must withhold social security or railroad retirement tax and any income tax due on the tips you report. Your employer usually deducts the withholding due on tips from your regular wages. But you do not have to have income tax withheld if you can claim exemption from withholding. You can claim exemption only if you had no income tax liability last year and expect none this year. See *Exemption From Withholding* in Chapter 5 for more information.

Employer's recordkeeping. Your employer may withhold an estimated amount from your wages to cover the tax on your tips. Your employer also may require your written tip reports more than once a month and may deduct the taxes due on your reported tips even though they do not yet total $20. If this is done, your employer must adjust the amount of taxes withheld from time to time, based on the actual amount of tips you report.

Form W–2. The Form W–2, *Wage and Tax Statement*, which you get from your employer, includes your reported tips in your regular wages. It shows separately your social security wages and your social security tips. These amounts are included in the "wages, tips, other compensation" block of the form. The form also shows the social security and income taxes withheld on your tips. Any errors you find in these amounts should be brought to your employer's attention as soon as possible so you can obtain a corrected form.

Pay too low. If your regular pay is too low for your employer to withhold all the tax due on your pay plus your tips, you may give your employer extra money to pay the tax. Your employer will tell you how much is needed.

If you do not give your employer enough or any extra money, your employer will first withhold as much social security or railroad retirement tax as possible, and then withhold income tax up to the full amount of your pay.

You may pay estimated tax instead of giving your employer extra money. See Chapter 5 for information on estimated taxes.

Uncollected employee social security tax on tips. Box 17 (code A) on your Form W–2 will show the amount of social security tax on tips that your employer was unable to withhold and for which you did not give your employer extra money to pay the taxes.

You must file Form 1040, report the amount of uncollected tax on tips from Box 17 (code A) Form W–2, and pay it with your return, even if you do not otherwise have to file a return. Include the amount of uncollected employee social security tax on tips in the total on line 54 of Form 1040. On the dotted line next to this total, write "Uncollected Tax on Tips" and show the amount.

Limit on social security tax. For 1990, the wages you received from a nonrailroad employer and the tips you reported to that employer were subject to the withholding of social security tax until they reached a total of $51,300. Your employer withheld this tax at the rate of 7.65%. If you worked for two or more employers and the total social security tax withheld was more than $3,924.45 for 1990, you may be due a refund or a credit. See *Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld* in Chapter 35.

Limit on railroad retirement tax. Your pay and the tips you reported to your railroad employer during 1990 were subject to the withholding of tier 1 railroad retirement tax until they reached a total of $51,300. Your employer withheld this tax at the rate of 7.65%. In addition, your employer withheld tier 2 railroad retirement tax at the rate of 4.90% on the first $38,100 of your pay and tips. The maximum amount of railroad retirement tax that should have been withheld for services you performed during 1990 was $5,791.35 ($3,924.45 + $1,866.90). If you worked for two or more railroad employers and the total tier 1 tax withheld was more than $3,924.45, or the total tier 2 tax withheld was more than $1,866.90, for 1990, you may be due a refund or a credit. See *Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld* in Chapter 35.

Tips Not Reported to Employer

If you received tips of $20 or more in any month while working for one employer, but did not report all of them to your employer, you must figure your social security tax on the tips not reported. You should use Form 4137, *Social Security Tax on Unreported Tip Income*, and attach it to Form 1040. Enter the tax on line 51 in the *Other Taxes* section on page 2 of Form 1040. You also must include these tips in income on line 7 of your Form 1040. You may not use Form 1040EZ or Form 1040A.

Employees subject to the Railroad Retirement Tax Act. If you received tips of $20 or more in any month while working for a railroad employer and did not report them to your employer, you should contact your nearest Railroad Retirement Board office for information on how to determine the amount of railroad retirement tax on unreported tips and how you can get railroad retirement credit for all your tips. You should pay the railroad retirement tax on unreported tips when you file Form 1040. Enter the tax on line 51 in the *Other Taxes* section on page 2 of Form 1040 and write "RRTA" next to it on the dotted line. You also must include these tips in income on line 7 of your Form 1040. You may not use Form 1040EZ or Form 1040A.

Penalty for failure to report tips. If you do not report tips to your employer as required, you may be subject to a penalty equal to 50% of the employee social security or railroad retirement tax, in addition to the tax that you owe.

If you did not report tips to your employer as required, you should attach a statement to your return explaining why you did not report them.

Tip Allocation

Large food or beverage establishments are required to report to the IRS certain additional information about tips.

To make sure that employees are correctly reporting tips, employers must keep records to verify amounts reported by employees. Certain employers must allocate tips if the percentage of tips reported by employees falls below a required minimum percentage of gross sales. To "allocate tips" means to assign an additional amount as tips to each employee whose reported tips are below the required percentage.

How the rules work. If the rules on tip allocation apply to your employer's establishment, your employer may have to allocate to you a part of the difference between 8% (or some lower percentage) of the total sales of the operation and the amount of tips reported by all tipped employees. However, no allocation will be made to you if you report tips at least equal to your share of 8% of total sales.

If the customers do not tip 8% on the average, either your employer or a majority of the directly-tipped employees may petition to have the allocation percentage reduced from 8%. However, it cannot be reduced below 2%.

Your employer will report your allocated tip amount on your Form W–2 (in Box 7), separately from your wages and reported tips. Your employer bases withholding only on wages and reported tips. Your employer ***should not withhold*** income, social security, or railroad retirement tax from the allocated amount. Any incorrectly withheld taxes should be refunded to you.

Regardless of whether you receive a tip allocation, you are required to report as income all tips received. The tip allocation amount may be added to your gross income unless you are able to prove a lesser amount with adequate records. The IRS may determine that you received a larger amount of tip income than is reflected by the tip allocation.

For more information on these requirements, see *Tip Allocation* in Publication 531, *Reporting Income From Tips*.

8. Interest Income

Important Change for 1990

Education Savings Bond Program. Beginning in 1990, you may be able to exclude from income interest on qualified U.S. savings bonds that you redeem if you pay for qualified higher educational expenses. These are expenses for tuition and required fees at an eligible educational institution (college or eligible vocational school) for you, your spouse, or your dependent. A "qualified U.S. savings bond" is a Series EE savings bond that is ***issued after*** December 31, 1989, to an individual 24 years of age or older.

Important Reminders

Child's income reported on parent's return. You may choose to include your child's investment income on your tax return if certain requirements are met. If you make this choice, your child is not required to file a return.

Reporting tax-exempt interest. You must show on your tax return the amount of any tax-exempt interest you received or accrued during the tax year. This is an information-reporting requirement and does not convert tax-exempt interest to taxable interest. For more information, see *How to Report Interest Income*.

This chapter discusses the tax treatment of different types of interest income. In general, any interest that you receive or that is credited to your account and can be withdrawn is taxable income. (It does not have to be entered in your passbook.) However, interest that was credited in 1990 on deposits that you could not withdraw because of the bankruptcy or insolvency of the financial institution may not have to be included in your 1990 income. For details, see *Interest income on frozen deposits*, later in this chapter. Other exceptions to the interest income reporting rule are also discussed in this chapter.

As an important part of your records, you should keep a list showing sources and amounts of interest received during the year.

You may deduct expenses you have in earning this income on Schedule A (Form 1040) if you itemize your deductions. See Chapter 30.

If you need additional information on interest income that is not covered in this chapter, see Publication 550, *Investment Income and Expenses.*

General Information

A few items of general interest are covered here.

Passive activity income and losses. There are tax rules which limit the amount of losses and tax credits from passive activities that you can claim. Generally, only income from passive activities can be used to offset losses from passive activities. Consequently, you generally cannot use passive activity losses to offset your other income, such as your wages or your ***portfolio income*** (that is, any gross income from interest, dividends, etc., that is not derived in the ordinary course of a trade or business). For more information about determining and reporting income and losses from passive activities, see Publication 925, *Passive Activity and At-Risk Rules.*

Tax on investment income of a child under age 14. If a child is under age 14 at the end of the year and has more than $1,000 of investment income (such as taxable interest and dividends), part of his or her investment income may be taxed at the parents' tax rate if either parent is alive at the end of the year. If these requirements are met, **Form 8615,** *Tax for Children Under Age 14 Who Have Investment Income of More Than $1,000,* must be completed and attached to the child's tax return. If these requirements are not met, Form 8615 is not required and the child's income is taxed at his or her own tax rate.

However, the parent can choose to include the child's interest and dividends on the parent's return if certain requirements are met. **Form 8814,** *Parent's Election To Report Child's Interest and Dividends,* is used for this purpose.

For more information about the tax on investment income of children and the parent's election, see Chapter 32.

Beneficiary of an estate or trust. Interest, dividends, or other investment income you receive as a beneficiary of an estate or trust is generally taxable income. You should receive a **Schedule K–1** (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.—1990,* from the fiduciary. Your copy of Schedule K–1 and its instructions will tell you where to report the items from Schedule K–1 on your Form 1040.

Backup withholding. To ensure that income tax is collected on interest and other types of income that generally are not subject to withholding, backup withholding will apply in certain circumstances.

Under backup withholding, when you open a new account you must certify under penalties of perjury that your social security number is correct and that you are not subject to backup withholding. If you fail to make this certification, backup withholding may begin immediately on your new account or investment and 20% of the interest paid on your account will be withheld. Your payer will give you a **Form W–9,** *Request for Taxpayer Identification Number and Certification,* or a similar form to make this certification. Backup withholding may also be required if the Internal Revenue Service (IRS) has determined that you underreported your interest or dividend income. For more information, see *Backup Withholding* in Chapter 5.

Social security number. You must give your name and social security number to any person required by federal tax law to make a return, statement, or other document that relates to you. This includes payers of interest. If you are married and the funds in a joint account belong to you, you should give your social security number to the payer of the interest. If the funds in the account belong to both you and your spouse, you may give either your number or your spouse's number, so long as the number you provide corresponds with the name listed on the account. You must give the payer the correct social security number if the number being used is wrong.

If you do not give your social security number to the payer of interest, you may have to pay a penalty. See *Penalty for failure to supply social security number* under *Penalties* in Chapter 1. Backup withholding also may apply. See *Backup Withholding* in Chapter 5.

Joint accounts. In a joint account, two or more persons, such as you and your spouse, hold a savings account, bonds, or other property that pays interest, as ***joint tenants, tenants by the entirety, or tenants in common.*** Each person receives a share of any interest from the property. Each person's share is determined by local law.

Income from property given to a child. Property you give as a parent to your child under a Model Gifts of Securities to Minors Act, a Uniform Gifts to Minors Act, or any similar law, is a true gift for federal gift tax purposes.

Income from property transferred under these Acts is taxable to the child unless it is used in any way to satisfy a legal obligation of support of that child. The income is taxable to the person having the legal obligation to support the child (parent or guardian) to the extent that it is used for the child's support.

Savings account with parent as trustee. Interest income derived from a savings account opened for a child or minor but placed in the name, and subject to the order, of the parents as trustees is taxable to the child, if, under the law of the state in which the minor resides:

1) The savings account legally belongs to the child, and
2) The parents are not legally permitted to use any of the funds to support the child.

Form 1099–INT. Interest income is generally reported to you on Form 1099–INT, *Statement for Recipients of Interest Income,* or a similar statement, by banks, savings and loans, and other payers of interest. This form shows you the interest you received during the year. Keep this form for your records. You do not have to attach it to your tax return.

Report on your tax return the total amount of interest income that is shown on any Form 1099–INT that you receive for the tax year. You must report all of your taxable interest income even if you do not receive a Form 1099–INT.

Reporting backup withholding. If backup withholding is deducted from your interest income, the payer must give you a Form 1099–INT that indicates the amount withheld. Any backup withholding will be shown on Form 1099 as "Federal income tax withheld."

Nominees. Generally, if someone receives interest as a nominee for you, that person will give you a Form 1099–INT showing the interest they received on your behalf.

If you receive a Form 1099–INT that includes amounts belonging to another person, see the discussion on nominee distributions, later, under *How to Report Interest Income.*

Incorrect amount. If you receive a Form 1099–INT that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The corrected Form 1099–INT you receive will be marked "CORRECTED."

Interest on Form 1099–OID. Reportable interest income may also be shown on Form 1099–OID, *Statement for Recipients of Original Issue Discount.* For more information about amounts shown on this form, see *Original Issue Discount (OID),* later in this chapter.

Accuracy-related penalties. For tax returns due after 1989, a 20% accuracy-related penalty may be charged for underpayments of tax due to negligence or disregard of rules and regulations or substantial understatement of tax. For more information on the penalty and any applicable interest, see *Penalties* in Chapter 1.

Individual Retirement Arrangements (IRAs). Interest that you earn on an IRA is not included in your income until you make withdrawals from the IRA. Nor is it included in the amount to be reported as tax-exempt interest. See Chapter 19.

Exempt-interest dividends you receive from a regulated investment company (mutual fund) are not included in your taxable income. (However, see *Information reporting requirement,* next.) You will receive a notice from the mutual fund telling you the amount of the tax-exempt-interest dividends that you received. Exempt-interest dividends are not shown on Form 1099–DIV or Form 1099–INT.

Information reporting requirement. Although these dividends are not taxable, you must show them on your tax return if you are required to file. This is an information reporting requirement and does ***not*** convert the exempt-interest dividend to taxable income. See *How to Report Interest Income,* later. Also, exempt-interest dividends may be treated as tax-exempt interest on specified private activity bonds, which is a "tax preference item" that may be subject to the alternative minimum tax. See *Alternative Minimum Tax* in Chapter 31 for more information. Publication 550 contains a discussion on private activity bonds, under *State or Local Government Obligations.*

Interest income on frozen deposits. Under certain circumstances, you may choose to exclude from your income amounts of interest credited during 1990 on deposits that you could not withdraw by the end of 1990 because of the bankruptcy or insolvency of the financial institution, or because the state where the financial institution is located has placed limits on withdrawals because other banks in the state are bankrupt or insolvent.

The amount of interest you can exclude from gross income in 1990 is the interest that was credited on the frozen deposits minus the sum of:

1) The net amount you withdrew from these deposits during 1990, and
2) The amount you could withdraw as of the end of 1990 (not reduced by any penalty

for premature withdrawals of a time deposit).

Report the excluded part of the interest in your gross income in the tax year in which it is withdrawable. If you receive a Form 1099–INT for interest income on deposits that were frozen at the end of 1990, see *Frozen deposits* later under *How to Report Interest Income*, for information about reporting this interest income exclusion on your 1990 tax return.

Taxable Interest

Taxable interest includes interest you receive from bank accounts, loans you make to others, and interest from most other sources. The following are some other sources of taxable interest.

Dividends that are actually interest. Certain distributions commonly referred to as dividends are actually interest. You must report as interest so-called "dividends" on deposits or on share accounts in:

- Cooperative Banks
- Credit Unions
- Domestic Building and Loan Associations
- Domestic Savings and Loan Associations
- Federal Savings and Loan Associations
- Mutual Savings Banks

Money market funds. Generally, amounts you receive from money market funds should be reported as dividends, not as interest.

Money market certificates, savings certificates, and other deferred interest accounts. If you open any of these accounts, and interest is paid at fixed intervals of one year or less during the term of the account, you must include this interest in your income when you actually receive it or are entitled to receive it without paying a substantial penalty. The same is true for accounts that mature in one year or less and give a single payment of interest at maturity. If interest is deferred for more than one year, see *Original Issue Discount (OID)*, later.

Money borrowed to invest in money market certificate. The interest you pay on money borrowed from a bank or savings institution to meet the minimum deposit required for a money market certificate from the institution and the interest you earn on the certificate are two separate items. You must report the total interest you earn on the certificate in your income. You may deduct the interest you pay, as investment interest subject to certain limits, only if you itemize deductions.

Example. You deposit $5,000 with a bank and borrow $5,000 from the bank to make up the $10,000 minimum deposit required to buy a 6–month money market certificate. The certificate earns $575 at maturity in 1990, but you receive only $265, which represents the $575 you earned minus $310 interest charged on your $5,000 loan. The bank gives you a Form 1099–INT for 1990 showing the $575 interest you earned. The bank also gives you a statement showing that you paid $310 interest for 1990. You must include the $575 in your income. You may deduct $310 on Schedule A (Form 1040) if you itemize your deductions, subject to the investment interest expense limitation.

The fair market value of "gifts" or services you receive for making long-term deposits or for opening accounts in savings institutions is interest. Report it in income in the year you receive it.

Example. In 1990, you open a savings account at your local bank. The account earns $20, which is credited as interest. You also receive a $10 calculator. If no other interest is credited to your account during 1990, the Form 1099–INT you receive would show $30 interest income for 1990.

Interest on insurance dividends that you leave on deposit with an insurance company, that is credited annually, and that can be withdrawn annually, is taxable to you when the interest is credited to your account. However, if you can only withdraw it on the anniversary date of the policy (or other specified date), the interest is taxable in the year in which that date occurs.

Interest on GI insurance dividends you leave on deposit with the Department of Veterans Affairs is taxable.

Prepaid insurance premiums. Any increase in the value of prepaid insurance premiums, advance premiums, or premium deposit funds is interest if it is applied to the payment of premiums due on insurance policies or made available for you to withdraw. Your insurance company must give you a Form 1099–INT showing the interest you earned for the year if you had $10 or more of interest income from that company.

Interest on U.S. obligations, such as U.S. Treasury bills, notes, and bonds, issued by any agency or instrumentality of the United States, is taxable for federal income tax purposes, but is exempt from all state and local income taxes.

Treasury bills are issued at a discount and the interest is the difference between the discounted price you pay for the bills and the face value you receive at maturity. Report this interest income when the bill is paid at maturity. On Treasury notes and bonds, interest is paid at stated intervals by interest checks or by direct deposit to your designated checking or savings account through the TREASURY DIRECT system. For more information, see *U.S. Treasury Bills, Notes, and Bonds* in Publication 550.

For information on Series EE and Series HH Savings Bonds, see *U.S. Savings Bonds*, later.

Interest on tax refund. If you receive a tax refund that includes interest on the amount refunded, the interest is taxable.

Interest on condemnation awards. If the condemning authority pays you interest to compensate you for a delay in paying an award, the interest is taxable.

Installment sale payments. Certain deferred payments you receive under a contract for the sale or exchange of property provide for interest that is taxable. If little or no interest is provided for in certain contracts with payments due more than one year after the date of sale, each payment due more than 6 months after the date of sale will be treated as containing interest. The unstated interest rules apply to certain payments received on account of a ***seller-financed*** sale or exchange of property. See Publication 537, *Installment Sales*.

Accumulated interest on an annuity contract you sell before its maturity date is taxable.

Usurious interest is taxable unless state law automatically changes it to a payment on the principal. Usurious interest is interest charged at an illegal rate.

Accrued interest on bonds. If you sell bonds between interest payment dates, the accrued interest paid to you is taxable. See *Bonds Sold Between Interest Dates*, later.

Bonds traded flat. If you purchase bonds when interest has been defaulted or when the interest has accrued but has not been paid, that interest is not income and is not taxable as interest if later paid. Such payments are returns of capital which reduce the remaining cost basis. Interest which accrues after the date of purchase, however, is taxable interest income for the year in which received or accrued. See *Bonds Sold Between Interest Dates*, later, for more information.

Interest on below-market interest rate loans. A below-market loan is a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate. These loans are discussed in Chapter 24 under *Personal Interest*.

U.S. Savings Bonds

You may earn interest on U.S. Savings Bonds in one of two ways. On some bonds, interest is paid at stated intervals by interest checks or coupons. Other bonds are issued at a discount and pay all interest at redemption or maturity. The interest on the latter is the difference between what you pay for the bond and its redemption or maturity value.

This section provides information on different types of U.S. Savings Bonds, how to report the interest income on these bonds, and how to treat transfers of these bonds.

Cash method taxpayers. If you are a cash method taxpayer, as most individual taxpayers are, you generally report the interest on U.S. Savings Bonds when you receive it. The cash method of accounting is explained in Chapter 1, under *Accounting Periods and Methods*.

Accrual method taxpayers. If you are an accrual method taxpayer, you must report interest on U.S. Savings Bonds each year as it accrues. You may not defer reporting interest until you receive it or the bonds mature. The accrual method of accounting is explained in Chapter 1, under *Accounting Periods and Methods*.

Series HH Bonds. These bonds are issued at face value. Interest is paid twice a year by check. If you are a cash method taxpayer, you must report interest on these bonds as income in the year you receive it.

Series HH Bonds were first offered in 1980. Before 1980, ***Series H Bonds*** were issued. Series H Bonds are treated the same as Series HH Bonds. If you are a cash method taxpayer, you must report the interest when you receive it.

Series EE Bonds. These bonds are issued at a discount. You pay less than the face amount for the bonds. The face amount is payable to you at maturity. The difference between the purchase price and the redemption value is taxable interest.

Series EE Bonds were first offered in 1980. Before 1980, ***Series E Bonds*** were issued. If you own either Series EE or Series E Bonds and use the cash method of reporting income, you may:

1) Defer reporting the interest until the earlier of the year you cash the bonds or the year in which they finally mature (***method 1***), or
2) Choose to report the increase in redemption value as interest each year (***method 2***).

If you want to change your method of reporting the interest from method (1) to method (2), you may do so without permission from the IRS. However, in the year of change you must report all interest accrued to date and not previously reported for all such bonds.

Once you choose to report the interest each year, you must continue to do so for all Series EE or Series E Bonds you own and for any you get later, unless you request permission to change, as discussed next.

Form 3115. To change from method (2) to method (1), complete **Form 3115,** *Application for Change in Accounting Method,* and attach it to your income tax return for the year of change. Type or print at the top of page 1 of the Form 3115 "*Filed Under Rev. Proc. 89–46.*" The return must be filed by the due date (including extensions). You must identify the savings bonds for which this change in accounting method is requested.

Permission for the change is automatically granted if you attach to Form 3115 a statement that you agree to report all interest on the bonds acquired:

1) During the year of change and for all subsequent tax years when the interest is realized upon disposition, redemption, or final maturity, whichever is earlier, and
2) Before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earlier, with the exception of any interest income previously reported in prior tax years.

Note. If you plan to redeem Series EE bonds in the same year that you pay for higher education expenses, you ***should*** use method (1). See *Education Savings Bond Program,* later, for more information.

If you hold the bonds beyond the original maturity period, and you have chosen to report the interest each year, you must continue to do so unless you get permission to change your method of reporting. If you have chosen to defer reporting the interest, you need not include the interest in income for the year of original maturity. Report it in the year you redeem the bonds or the year in which the extended maturity period ends, whichever is earlier. The original maturity period has been extended on all Series E Bonds.

Series E Bonds issued between May 1941 and April 1952 have a term of 40 years, and the Department of the Treasury has announced that no further extension will be given to these bonds. Therefore, if you have deferred reporting interest on Series E Bonds purchased in 1950, you must report the interest on your 1990 return, unless you trade your Series E Bonds for Series HH Bonds.

Co-owners. If you buy a U.S. Savings Bond issued in your name and another person's name as co-owners, such as you and your child or you and your spouse, interest on the bond is taxable to the co-owner who bought the bond. If you used your funds to buy the bond, you must pay the tax on the interest. This is true even if you let the other co-owner redeem the bond and keep all the proceeds. Under these circumstances, since the other co-owner will receive a Form 1099–INT at the time of redemption, the other co-owner must provide you with another Form 1099–INT showing the amount of interest from the bond that is taxable to you. See *Nominee distributions and accrued interest,* later, under *How to Report Interest Income,* for more information about providing a Form 1099–INT to another person.

Ownership transferred. If you bought Series EE or Series E Bonds entirely with ***your own funds*** and have them reissued in your co-owner's name or beneficiary's name alone, you must include in your gross income for the year of reissue all interest that you earned on such bonds and have not previously reported. But, if the bonds were reissued in your name alone, you do not have to report the interest accrued at that time. This same rule applies when bonds are transferred between spouses incident to divorce.

Purchased jointly. If you buy Series EE or Series E Bonds ***jointly*** with a co-owner and have them reissued in the co-owner's name alone, you must include in your gross income for the year of reissue your share of all the interest earned on the bonds that you have not previously reported. At the time of reissue, the former co-owner does not have to include in gross income his or her share of the interest earned that was not reported before the transfer. This interest, however, as well as all interest earned after the reissue, is income to the former co-owner.

This income reporting rule also applies when the bonds are reissued in the name of your former co-owner and a new co-owner, except that the new co-owner will report only his or her share of the interest earned after the transfer.

If bonds that you and a co-owner bought ***jointly*** are reissued to each of you separately in the same proportion as your contribution to the purchase price, neither you nor your co-owner has to report at that time the interest earned before the bonds were reissued.

Example. You and your spouse each spent an equal amount to buy a $1,000 Series EE Savings Bond. The bond was issued to you as co-owners. You both defer reporting interest on the bond. You later have the bond reissued as two $500 bonds, one in your name and one in your spouse's name. At that time neither you nor your spouse has to report the interest earned to the date of reissue. But if you bought the $1,000 bond entirely with your own funds, you must report half the interest earned to the date of reissue. This is the previously deferred interest earned on the $1,000 bond that is attributable to the $500 bond issued to your spouse.

Transfer to a trust. If you own Series EE or Series E Bonds and transfer them to a trust, giving up all rights of ownership, you must include in your income for that year the interest earned to the date of transfer, if you have not already reported it. However, if you are considered the owner of the trust and if the increase in value both before and after the transfer continues to be taxable to you, you may continue to defer reporting the interest earned each year. You must include the total interest in your income when the bonds are cashed or finally mature, whichever is earlier.

The same rules apply to previously unreported interest on Series EE or Series E Bonds if the transfer to a trust consisted of Series HH or Series H Bonds you got in a trade for the Series EE or Series E Bonds. See *Savings bonds traded,* later.

Decedents. The manner of reporting interest income on Series EE or Series E Bonds, after death of the owner, depends on the accounting and income reporting method previously used by the decedent. If the bonds transferred because of death were owned by a person who used the accrual method, or who used the cash method and had chosen to report the interest each year, the interest earned in the year of death up to the date of death must be reported on that person's final return. The person who acquires the bonds includes in income only interest earned after the date of death.

If the transferred bonds were owned by a decedent who used the cash method and had not chosen to report the interest each year, and who bought the bonds entirely with his or her own funds, all interest earned before death must be reported in one of the following ways:

1) The surviving spouse or personal representative (executor, administrator, etc.) who files the final income tax return of the decedent may choose to include on that return all of the interest earned on the bonds before the decedent's death. The person who acquires the bonds then includes in income only interest earned after the date of death, or
2) If the choice in (1) is not made, the interest earned up to the date of death is income in respect of a decedent. It should not be included in the decedent's final return. All of the interest earned both before and after the decedent's death is income to the person who acquires the bonds. If that person uses the cash method and does not choose to report the interest each year, he or she may defer reporting any of it until the bonds are cashed or finally mature, whichever is earlier. In the year that person reports the interest, he or she may claim a deduction for any federal estate tax paid that was for the part of the interest included in the decedent's estate.

For more information on income in respect of a decedent, see Chapter 4.

Savings bonds traded. If you traded Series E Bonds for Series H Bonds, or traded Series EE or Series E Bonds for Series HH Bonds, you did not realize taxable income unless you received cash in the trade. Any cash you received is income to the extent of the interest earned on the bonds traded. When your Series HH or Series H Bonds mature, or if you dispose of them before maturity, you report as interest the difference between their redemption value and your cost. Your cost is the sum of your cost of the traded Series EE or Series E Bonds plus any amount you had to pay at the time of the trade.

Example. You trade Series E Bonds with a redemption value of $2,723.35 for Series HH Bonds. You get $2,500 in Series HH Bonds and $223.35 in cash. You must report the $223.35 as taxable income in the year of the trade to the extent that you did not report interest on the Series E Bonds you traded.

$500 minimum value. Series EE or Series E Bonds that you want to trade must have a current redemption value of $500 or more. To figure the current redemption value of the bonds to be traded, you must add the accrued interest to their original purchase price.

You can choose to treat all of the accrued interest on the Series EE or Series E Bonds traded for Series HH Bonds as income in the year of the trade.

Form 1099–INT for U.S. Savings Bonds interest. When you cash a bond, the bank or other payer that redeems it must give you a Form 1099–INT if the interest part of the

payment you receive is $10 or more. Box 3 of your Form 1099–INT should show the interest as the difference between the amount you received and the amount paid for the bond. However, your Form 1099–INT may show more interest than you are required to include on your income tax return. For example, this may happen if:

1) You chose to report the increase in the redemption value of the bond each year. The interest shown on your Form 1099–INT will not be reduced by amounts previously included in income.
2) You received a bond from a decedent. The interest shown on your Form 1099–INT will not be reduced by any interest reported by the decedent before death, or on the decedent's final return, or by the estate on the estate's income tax return.
3) Ownership of a bond was transferred. The interest shown on your Form 1099–INT will not be reduced by interest that accrued prior to the transfer.
4) You redeemed a bond on which you were named as a co-owner but for which you did not use your funds to buy the bond. (See *Co-owners*, earlier in this chapter, for more information about the reporting requirements.)
5) You received a taxable distribution of bonds from a retirement or profit-sharing plan. The interest shown on your Form 1099–INT will not be reduced by the interest portion of amounts taxable as a distribution from a retirement or profit-sharing plan and not taxable as interest. (These amounts are generally shown on Form 1099–R, *Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.*)

For information on including the correct amount of interest on your return for (1), (2), (3), and (4) above, see *How to Report Interest Income*, later. Publication 550 includes examples showing how to report these amounts.

If you received a taxable distribution of bonds from a retirement or profit-sharing plan ((5), above), see *Interest from U.S. Savings Bonds* under *How to Report Interest Income* in Publication 550 for information on how to report the interest.

Note. U.S. Savings Bond interest is exempt from state and local taxes. The Form 1099–INT you receive will indicate the amount that is for U.S. Savings Bond interest in Box 3. Do not include this amount on your state or local income tax return.

Education Savings Bond Program. Beginning in 1990, you may be able to exclude from income all or part of the interest you receive on the redemption of qualified U.S. Savings Bonds if you pay qualified higher educational expenses during the year. This exclusion is known as the *Education Savings Bond Program.*

Married taxpayers who file separate returns *do not* qualify for this exclusion.

Qualified U.S. Savings Bonds. A qualified U.S. Savings Bond is a Series EE U.S. Savings Bond issued after December 31, 1989. The bond must be issued either in your name (sole owner) or in your and your spouse's name (co-owners). You must be at least 24 years old before the bond's issue date.

The date a bond is issued may precede the date the bond is purchased because bonds are issued as of the first day of the month in which they are purchased. You may designate any individual (including a child) as a beneficiary of the bond (payable on death).

Qualified higher educational expenses are tuition and fees required for you, your spouse, or your dependent to attend an eligible educational institution. Eligible expenses do not include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree program.

Eligible educational institutions are those which qualify for federal assistance and include most public and nonprofit universities and colleges and certain vocational schools.

Amount excludable. To exclude all of the interest, the total redemption proceeds (interest and principal) from the qualified U.S. Savings Bonds you redeem during the year must not be more than your qualified higher educational expenses for the year. If the proceeds are more than the expenses, you will only be able to exclude part of the interest.

To determine the excludable amount, multiply the interest part of the redemption proceeds by a fraction. The numerator (top part) of the fraction is the qualified higher educational expenses you paid during the year. The denominator (bottom part) of the fraction is the total redemption proceeds you received during the year.

Example. In December 1990, Mark and Joan, a married couple, cashed qualified Series EE U.S. Savings Bonds they bought in January 1990. That year, they helped pay for their daughter's college tuition. They received proceeds of $1,039.20, representing principal of $1,000 and interest of $39.20. The qualified higher educational expenses they paid during 1990 totaled $650. They can exclude $24.52 ($39.20 × ($650 ÷ $1,039.20)) of interest in 1990.

Exclusion reduced for certain benefits. Before you figure your interest exclusion, you must reduce your qualified higher educational expenses by certain benefits the student may have received. These benefits include qualified scholarships that are exempt from tax and any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses, such as Department of Veterans Affairs educational assistance benefits and employer-provided educational assistance benefits. See Publication 520, *Scholarships and Fellowships*, for more information on qualified scholarships.

Modified adjusted gross income limit. The interest exclusion is phased out if the modified adjusted gross income (modified AGI) is:

- $40,000 to $55,000 for taxpayers filing single, head of household, or qualifying widow(er) with dependent child; and
- $60,000 to $90,000 for married taxpayers filing jointly.

You do not qualify for the interest exclusion if your modified AGI is more than these limits.

Modified AGI, for purposes of this exclusion, is adjusted gross income (line 16 of Form 1040A or line 31 of Form 1040) figured *before* the interest exclusion, modified by adding back any:

1) Foreign earned income exclusion,
2) Foreign housing exclusion or deduction,
3) Exclusion for income from certain U.S. possessions, and
4) Exclusion for income from sources within Puerto Rico.

If you do not have any of these items, your modified AGI is your adjusted gross income before the interest exclusion.

Form 8815. Use Form 8815, *Exclusion of Interest From Series EE U.S. Savings Bonds Issued After 1989*, to figure your exclusion and to compute your modified AGI.

Recordkeeping. If you claim the interest exclusion, you must keep a written record of the post-1989 Series EE U.S. Savings Bonds that you redeem. Your written record must include the serial number, issue date, face value, and redemption proceeds of each post-1989 Series EE bond. You may use **Form 8818,** *Optional Form To Record Redemption of College Savings Bonds*, to keep this information.

You should also keep bills, receipts, canceled checks, or other documentation that shows you paid qualified higher educational expenses during the year.

Bonds Sold Between Interest Dates

When bonds are sold between interest dates, part of the sales price represents interest accrued to the date of sale. The seller must report this amount as taxable interest. The purchaser may treat this amount as a capital investment and deduct it from the next interest payment as a return of capital, but must report the total payment as taxable interest and show the accrued interest as an adjustment (or subtraction). See *Nominee distributions and accrued interest* later under *How to Report Interest Income* for information about making this adjustment.

If the bond is an original issue discount debt instrument, see *Original Issue Discount (OID)*, later, to determine the OID you must include in income. Also, see *Original issue discount (OID)*, under *How to Report Interest Income*, for information on how to report OID on your income tax return.

If the bond has market discount, see *Market discount bonds* later under *Original Issue Discount (OID)* for information about the accrued market discount that must be recognized as interest income.

Insurance Received in Installments

If insurance proceeds are payable to you because your spouse died before October 23, 1986, and you receive the proceeds in installments, you can exclude up to $1,000 a year of the interest included in the installments. This $1,000 interest exclusion is in addition to the part of each installment that you do not include in income because it is a recovery of the lump sum payable at death. (See *Life Insurance Proceeds* in Chapter 13.) If you later remarry, you can continue to take the $1,000 interest exclusion. If your spouse died after October 22, 1986, you do not qualify for the $1,000 interest exclusion.

Example. Fern Green, a widow whose husband died in June 1986, chooses to receive the proceeds of her husband's $75,000 life insurance policy in ten yearly installments of

$11,250. The payments are based on a guaranteed interest rate. She will include $2,750 in income each year. She figures this as follows:

Fixed payment	$11,250
Minus: Amount of insurance principal ($75,000 ÷ 10)	7,500
Interest included in installment	$ 3,750
Minus: Annual $1,000 interest exclusion	1,000
Amount included in gross income	$ 2,750

If you buy an annuity with life insurance proceeds, the annuity payments you receive are taxed as pension and annuity income, not as interest income. See Publication 939, *Pension General Rule (Nonsimplified Method).*

For more information about the tax treatment of insurance proceeds, see *Life Insurance Proceeds* in Publication 525, *Taxable and Nontaxable Income.*

Original Issue Discount (OID)

A long-term debt instrument, such as a bond, note, or other evidence of indebtedness, generally has original issue discount (OID) when the instrument is issued for a price that is less than its stated redemption price at maturity (principal amount). The amount of OID is the difference between the principal amount and the issue price of the instrument. OID is a form of interest; however, you report OID as it accrues, whether or not you receive any payments from the bond issuer. All long-term debt instruments that pay no interest prior to maturity are presumed to be issued at a discount. Zero-coupon bonds are one example of such instruments.

The OID rules do not apply to short-term obligations with a fixed maturity date of one year or less from date of issue. See *Discount on Short-Term Obligations,* in Publication 550.

De minimis OID. You may disregard the discount and treat it as zero if it is less than one-fourth of 1% (.25%) of the stated redemption price at maturity, multiplied by the number of full years from the date of original issue to maturity. This small discount is known as "de minimis OID."

Example 1. You bought a 10-year bond, with a stated redemption price at maturity of $1,000, issued at $980 and having OID of $20. One-fourth of 1% of $1,000 (stated redemption price) times 10 (number of full years from the date of original issue to maturity) equals $25. Because the $20 discount is less than $25, you may disregard reporting the OID.

Example 2. Assume the same facts as in Example 1, except that the bond was issued at $950. The OID is $50. Because the $50 discount is more than the $25 figured in Example 1, you must report the OID.

Form 1099-OID. The issuer of the debt instrument (or your broker, if you purchased the instrument on a secondary market) should give you a copy of Form 1099-OID, *Statement for Recipients of Original Issue Discount,* or a similar statement, if the total OID for the calendar year is $10 or more. Form 1099-OID shows the amount of OID for the calendar year. It also will show the stated interest that you must include in your income. A copy of Form 1099-OID will be sent to the IRS. Do not file your copy with your return. Keep it for your records. See *Recomputation of OID shown on Form 1099-OID,* later in this discussion and also *Original issue discount (OID)* under *How to Report Interest Income,* for more information.

If you had OID for 1990 but did not receive a Form 1099-OID, see Publication 1212, *List of Original Issue Discount Instruments.* Publication 1212 lists total OID on certain debt instruments and gives information on computing OID. If your debt instrument is not listed in Publication 1212, consult the issuer for further information about the OID that accrued for 1990.

Nominee. If someone is the holder of record of an OID instrument that belongs to you and receives a Form 1099-OID on your behalf, that person must give you a Form 1099-OID. The form should show the OID for the entire year regardless of whether you owned or held the instrument for the entire year.

Debt instrument bought at premium. If you buy at a premium a debt instrument that was originally issued at a discount, you do not have to report any OID as ordinary income. ***Premium*** means a purchase price that exceeds the stated redemption price of the instrument at maturity. When you sell or redeem an instrument bought at a premium, the difference between the sale or redemption price and your purchase price is a capital gain or loss.

This rule, however, does not apply if you bought a debt instrument and paid an "acquisition premium." See *Acquisition premium,* later in this discussion, for more information about the treatment of this type of premium.

Exceptions to the OID rules. The OID rules discussed in this chapter for publicly offered, long-term instruments do not apply to the following debt instruments:

1) Tax-exempt obligations (however, see *Stripped tax-exempt obligations* under *Stripped Bonds and Coupons* in Publication 550),
2) U.S. Savings Bonds,
3) Short-term debt instruments which have fixed maturity dates of not more than one year from the date of issue,
4) Obligations issued by an individual before March 2, 1984, and
5) Loans of $10,000 or less from individuals (when increased by the outstanding amount of prior loans by that individual to the other individual) who are not in the business of lending money. (This exception does not apply if a principal purpose of the loan is to avoid any federal tax.)

Debt instruments issued after 1954 and before May 28, 1969 (or before July 2, 1982, if a government instrument). For these instruments, you pay no tax on the OID until the year the instrument is sold, exchanged, or redeemed. If a gain results, and if the instrument is a capital asset, the amount of the gain equal to the OID is taxed as ordinary interest income. The balance of the gain is capital gain. If there is a loss on the sale of the instrument, the entire loss is a capital loss and no reporting of OID is required.

Corporate debt instruments issued after May 27, 1969, and before July 2, 1982. If you hold these debt instruments as capital assets, you must include a part of the discount in your gross income each year that you own the instruments. Your basis in the instrument is increased by the amount of OID that you include in your gross income.

If you bought the instruments ***at original issue*** and held them for all of 1990, or the part of 1990 that they were outstanding, include in your gross income the total OID from Form 1099-OID. If the instruments you bought at original issue were outstanding for all of 1990, but you did not hold them for the entire year, figure your taxable OID as follows. Divide the total OID for 1990 by 12 and multiply the result by the number of complete and partial ***months*** (for example, 6½ months) you held the instruments in 1990.

If you bought the instrument ***after its original issue,*** see *Recomputation of OID shown on Form 1099-OID,* later, for more information.

Debt instruments issued after July 1, 1982, and before January 1, 1985. If you hold these debt instruments as capital assets, you must include a part of the discount in your gross income each year and increase your basis by the amount included. You report the total OID from Form 1099-OID if you bought the instruments at original issue and held them all of 1990 (or the part of 1989 that they were outstanding). However, if the instruments you bought at original issue were outstanding for all of 1990, but you did not hold them the entire year, figure your taxable OID as follows. Divide the total OID for 1990 (shown on Form 1099-OID) by 365 and multiply the result by the number of ***days*** you held the instrument in 1990. This simple computation, however, is an approximation and may result in slightly higher taxable OID than if you follow the more exact constant interest method, using an accrual period of one year. Publication 1212 discusses this method under *Debt Instruments Issued After July 1, 1982, and Before January 1, 1985.*

If you did not acquire the debt instrument at its original issue, see *Recomputation of OID shown on Form 1099-OID,* discussed below.

Debt instruments issued after December 31, 1984. If you hold these debt instruments, the OID reporting rules, in general, are similar to those for debt instruments issued after July 1, 1982. However, you report the total applicable OID (based on the number of days in the accrual period) regardless of whether you hold that debt instrument as a capital asset. Your basis in the instrument is increased by the amount of OID that you include in your gross income. The method for determining the reportable discount on any OID instrument issued after 1984 is based on an accrual period of 6 months. For more information about determining reportable OID for these debt instruments, see *Debt Instruments Issued After December 31, 1984,* in Publication 1212.

Recomputation of OID shown on Form 1099-OID. If you bought a debt instrument ***at original issue*** and held it for all of 1990, or the part of 1990 that it was outstanding, include in your gross income the total OID and any other periodic interest shown in Box 1 and Box 2 of Form 1099-OID. However, because the amount of OID shown on Form 1099-OID may have been determined on the assumption that you purchased the related debt instrument at original issue and owned it for the entire calendar year (or every day of the calendar year that the instrument was outstanding), the amount of OID shown in Box 1 of Form 1099-OID may not be the correct amount for you to include in your income.

You must recompute your correct share of the OID shown in Box 1 of Form 1099-OID if

any of the following apply to your ownership or holding of a long-term OID debt instrument:

1) The corporate instrument bought by you at original issue was outstanding for all (or part) of 1990, but you did not hold it for the entire period it was outstanding in 1990, or
2) The corporate instrument was bought by you ***after its original issue,*** or
3) The debt instrument is a stripped bond or a stripped coupon (these include zero coupon U.S. Treasury-backed securities).

For each of these situations, see Publication 1212, which provides detailed information and examples about figuring the amount of OID to report on your income tax return. The rules for figuring OID are broken down in Publication 1212 to reflect the specific computations that apply to corporate long-term OID debt instruments issued before July 2, 1982, and to all long-term OID debt instruments issued after July 1, 1982.

Reporting correct amount of OID. If you are reporting OID in an amount greater or less than the amount shown on Form 1099–OID, see *Original issue discount (OID)* at the end of this chapter, for information about reporting the correct amount of OID on Schedule B (Form 1040).

If a Form 1099–OID is not received. If you had OID for 1990 but did not receive a Form 1099–OID, see Publication 1212 which lists total OID on certain debt instruments. If your debt instrument is not listed in Publication 1212, consult the issuer for further information about the OID that accrued for 1990.

Acquisition premium. If you bought a debt instrument for more than the original issue price plus accumulated OID from the date of issue, that excess amount (or acquisition premium) reduces the amount of discount includible in your income. See *Computation of reportable OID* in Publication 1212 for information about figuring this reduction.

REMIC regular interests. If you own a regular interest in a real estate mortgage investment conduit (REMIC), you will receive a Form 1099–OID and an additional written statement from your broker. Form 1099–OID shows the amount of OID and interest, if any, that accrued to you for the period you held the regular interest. You will not need to make any adjustments to the amounts reported even if you held the regular interest for only a portion of the calendar year. The additional written statement should also contain enough information to enable you to figure your accrual of market discount or amortizable bond premium. See *REMICs* in Publication 550 for more information.

Recomputation of periodic interest shown on Form 1099–OID. If you disposed of a corporate debt instrument or acquired it from another holder during 1990, see *Bonds Sold Between Interest Dates,* earlier, for information about the treatment of periodic interest that may be shown in Box 2 of Form 1099–OID for that instrument. See *Nominee distributions and accrued interest* under *How to Report Interest Income,* later, for information about reporting the correct amount of interest on Schedule B (Form 1040).

Stripped bonds and stripped coupons. Special rules apply to the sale and purchase of stripped bonds and stripped coupons after July 1, 1982. These rules also cover the treatment of zero coupon U.S. Treasury-backed securities. See *Rules for Figuring OID on Stripped Bonds and Stripped Coupons* in Publication 1212 for more information.

Certificates of deposit (CD) and similar deposit arrangements. If you purchase a CD or a similar deposit arrangement and the receipt of interest is deferred for more than one year, you must include in income each year a part of the total interest due and report it in the same way as other original issue discount (OID).

Examples of such deposit arrangements with banks, building and loan associations, etc., include:

Certificates of deposit
Time deposits
Bonus plans
Savings certificates
Deferred income certificates
Bonus savings certificates
Growth savings certificates

Interest subject to penalty for early withdrawal. If you deposit money in one of the arrangements listed above that has a term of one year or less, and you cannot withdraw the interest without losing a large part of it, you must include all the interest in income at the end of the term. However, you can deduct the entire penalty, even if it exceeds your interest income, on line 28 of Form 1040.

Example. On October 1, 1990, you invested $10,000 in a savings certificate that will pay you $10,600 on April 1, 1991. If you withdraw any part of the principal or interest before April 1, you will lose the first $300 of interest that you accrue. If you wait until April 1 to withdraw your investment, you will include the entire $600 in income for 1991.

Bearer certificates of deposit are not issued in the depositor's name and, therefore, are transferable from one individual to another. They are issued by banks for a deferred withdrawal period, usually a number of years. Interest is not usually paid until the certificates are redeemed by the bank at the end of this period.

Banks are required to provide the IRS and the person redeeming the bearer certificate with a Form 1099–INT.

Certificates of deposit issued after 1982 are generally required to be in registered form.

For more information about interest income from certificates of deposit, see *Original Issue Discount (OID)* in Publication 550.

Market discount bonds. A market discount bond is any bond having market discount except:

1) Short-term obligations with fixed maturity dates of up to one year from the date of issue,
2) Tax-exempt obligations,
3) U.S. Savings Bonds, and
4) Certain installment obligations.

Market discount arises when the value of a debt obligation decreases after its issue date, generally because of an increase in interest rates. If you buy a bond on the secondary market, it may have market discount.

If you dispose of a market discount bond issued after July 18, 1984, you generally must recognize the gain as interest income to the extent of the bond's accrued market discount. The balance of the gain is capital gain if the bond was a capital asset. For more information about the methods of figuring ***accrued market discount,*** see *Market Discount Bonds* in Publication 550.

Discount on short-term obligations. Certain holders of short-term obligations are required to accrue and include the discount on such obligations in current income. See *Discount on Short-Term Obligations* in Publication 550 for more information.

REMIC regular interests. If you are the holder of a regular interest in a real estate mortgage investment conduit (REMIC), or an interest in a collateralized debt obligation (CDO), that interest is considered to be a debt instrument for income tax purposes, whether or not it is in the form of a debt instrument. Accordingly, the OID, market discount, and income-reporting rules that apply to bonds and other debt instruments apply to such interests with certain modifications. For more information, see *Real Estate Mortgage Investment Conduits (REMICs) and Other Collateralized Debt Obligations (CDOs)* in Publication 550.

State or Local Government Obligations

Generally, interest on obligations of a state or local governments is tax exempt. This includes obligations of a state or one of its political subdivisions, the District of Columbia, a possession of the United States, or one of its political subdivisions, used to finance governmental operations. This includes interest on certain obligations issued after 1982 by Indian tribal governments recognized by the Secretary of the Treasury as having the right to exercise one or more sovereign powers.

If you receive a Form 1099–INT for interest paid on a tax-exempt obligation, see *Tax-exempt interest income* under *How to Report Interest Income.*

Interest on arbitrage bonds issued by state or local governments after October 9, 1969, and interest on private activity bonds generally is ***taxable.***

For more information on whether such interest is taxable or tax exempt, see *State or Local Government Obligations* in Publication 550.

Information reporting requirement. If you received or accrued any tax-exempt interest income (such as interest on certain state and municipal bonds), you must show that interest on your tax return if you are required to file. This is an information reporting requirement and does not convert tax-exempt interest to taxable interest. See *How to Report Interest Income,* later.

When to Report Interest Income

When you report your interest income depends on whether you use the cash-basis method or the accrual-basis method of reporting income.

Cash basis. If you use this method, you report your interest income in the year in which you actually or constructively receive it. Most individual taxpayers use this method. However, there are special rules for OID and certain U.S. Savings Bonds. See *U.S. Savings Bonds,* and *Original Issue Discount (OID),* earlier.

Example. On September 1, 1988, you loaned $2,000 at 12% a year. The note stated that principal and interest would be due on August 31, 1990. In 1990, you received $2,480 ($2,000 principal and $480 interest). If you use the cash-basis method, you must include in

income on your 1990 return the $480 interest you received in 1990.

You constructively receive income when it is credited to your account or made available to you. You do not need to have physical possession of it. For example, you are considered to receive interest, dividends, or other earnings on any deposit or account in a bank, savings and loan, or similar financial institution, or interest on life insurance policy dividends left to accumulate, when they are credited to your account and subject to your withdrawal. This is true even if they are not yet entered in your passbook.

You constructively receive income on the deposit or account even if you must:

1) Make withdrawals in multiples of even amounts,
2) Give a notice to withdraw before making the withdrawal,
3) Withdraw all or part of the account to withdraw the earnings, or
4) Pay a penalty on early withdrawals, unless the interest you are to receive on an early withdrawal or redemption is substantially less than the interest payable at maturity.

You constructively receive interest when it is credited to your account under a long-term savings plan that does not let you withdraw interest until a specified date, if the plan lets you freely withdraw your deposits of principal.

Accrual basis. If you use this method, you report your interest income when you earn it, whether or not you have received it.

Example. If, in the above example, you use the accrual method, you must include the interest in your income as you earn it. You would report the interest as follows: 1988, $80; 1989, $240; and 1990, $160.

Coupon bonds. Interest on coupon bonds is taxable in the year the coupon becomes due and payable. It does not matter when you mail the coupon for payment.

How to Report Interest Income

Generally, you report all of your taxable interest income on line 8a, Form 1040; line 8a, Form 1040A; or on line 2, Form 1040EZ. If your interest income is more than $400 or you are excluding interest under the Education Savings Bond Program, you may not use Form 1040EZ. Instead, you must complete the schedules for Form 1040A or Form 1040, as described later. In addition, you must use Form 1040 under certain circumstances described later.

Form 1099–INT. Your taxable interest income is shown in Box 1 of Form 1099–INT. Add this amount to any other taxable interest income you received.

If you had any tax-exempt interest income, or exempt-interest dividends from a mutual fund, you should report the total of this tax-exempt income on line 8b of Form 1040A or Form 1040; or write "TEI" in the space to the left of line 2 on Form 1040EZ. After "TEI," show the amount of your tax-exempt interest, but do not add tax-exempt interest in the total on Form 1040EZ, line 2.

If you forfeited interest income because of the early withdrawal of a time deposit, the deductible amount will be shown on Form 1099–INT, in Box 2 (early withdrawal penalty). If an amount appears in Box 2, you should file Form 1040 and report this amount on line 28 (penalty on early withdrawal of savings).

Box 3 of Form 1099–INT shows the amount of interest income you received from U.S. Savings Bonds, Treasury bills, Treasury notes, and Treasury bonds. Include the amount shown in Box 3 in your total taxable interest income, unless it includes an amount previously included in interest income. If you are redeeming U.S. Savings Bonds you bought after 1989 and you have qualified educational expenses, see *Form 8815* later. If part of the amount shown in Box 3 was previously included in interest income, see *Interest from U.S. Savings Bonds*, next.

If you were subject to backup withholding because, for example, you did not furnish your social security number to a payer, an amount will appear in Box 4 of Form 1099–INT (federal income tax withheld). Report the amount from Box 4, Form 1099–INT on Form 1040A, line 28a, or on Form 1040, line 55 (federal income tax withheld), and check the box.

If there are entries in Boxes 5 and 6 of Form 1099–INT, you must file Form 1040. Report the amount shown in Box 5 (foreign tax paid) on **Form 1116,** *Foreign Tax Credit,* unless you claim this amount on Schedule A of Form 1040 as other taxes. For more information on the credit and deduction, see Publication 514, *Foreign Tax Credit for Individuals.*

Interest from U.S. Savings Bonds. If you received a Form 1099–INT for U.S. Savings Bond interest, the form may show interest you are not required to report. See *Form 1099–INT for U.S. Savings Bonds interest,* earlier, under *U.S. Savings Bonds.*

If you have qualified education expenses (as discussed earlier under *Education Savings Bonds Program*), see *Form 8815* later for information on your interest exclusion.

You should show on line 1, Part I of Schedule B (Form 1040), or on line 1, Part I of Schedule 1 (Form 1040A), all the interest shown on your Form 1099–INT.

If Form 1099–INT includes interest you previously reported, make the following adjustment. On Schedule B, several lines above line 2, enter a subtotal of all interest listed on line 1. If you use Form 1040A, enter this subtotal several lines above line 2, Part I of Schedule 1. Below the subtotal write "U.S. Savings Bond Interest Previously Reported" and enter amounts previously reported or interest accrued prior to receiving the bond. (To figure the amount to enter for interest reported or being reported as a taxable distribution from a retirement or profit-sharing plan, see *Interest from U.S. Savings Bonds* in Publication 550.) Subtract these amounts from the subtotal and enter the result on line 2 of Schedule B (Form 1040) or on line 2, Part I of Schedule 1 (Form 1040A).

Form 8815. Use Form 8815, *Exclusion of Interest From Series EE U.S. Savings Bonds Issued After 1989,* to figure your interest exclusion when you redeem bonds and pay qualified higher educational expenses during the same year.

For more information on the exclusion and qualified higher educational expenses, see the earlier discussion under *Education Savings Bond Program.*

You do not qualify for the exclusion if you are married filing separately.

You must show your total interest from Series EE Savings Bonds on line 5 of Form 8815 and on line 1 of either Schedule 1 (Form 1040A) or Schedule B (Form 1040). After completing Form 8815, enter the result from line 14 (Form 8815) on line 3 of Schedule 1 (Form 1040A) or line 3 of Schedule B (Form 1040).

Form 1040A

If your taxable interest income totals more than $400 or you are claiming the interest exclusion under the Education Savings Bond Program, you must complete Part I of Schedule 1 (Form 1040A). List each payer's name and the amount of interest income received from each payer. If you received a Form 1099–INT or Form 1099–OID from a brokerage firm, list the brokerage firm as the payer. Attach Schedule 1 to your return.

However, you must use Form 1040 instead of Form 1040A if:

- You are reporting OID in an amount greater or less than the amount shown on Form 1099–OID,
- You received or paid accrued interest on securities transferred between interest payment dates, or
- You acquired taxable bonds after 1987 and choose to reduce interest income from the bonds by any amortizable bond premium (see *Bond Premium Amortization* in Publication 550).

Nominee distributions. If the total interest income you list on line 1, Part I of Schedule 1 (Form 1040A) includes any amount that you received as a nominee for the real owner, show such an amount separately below a subtotal of all interest income listed. Identify the amount as "Nominee Distribution," and subtract it from the interest income subtotal. Report the result on line 2, Part I of Schedule 1 (Form 1040A), and also on Form 1040A, line 8a.

For more information, see *Nominee distributions and accrued interest* later under *Form 1040.*

Tax-exempt interest income. If you received any tax-exempt interest, such as from state or local governmental obligations, do not include this income on line 8a. Instead, enter your tax-exempt interest on line 8b. Also include on line 8b any exempt-interest dividends received from a mutual fund or other regulated investment company.

Interest earned on an individual retirement arrangement (IRA) is tax deferred rather than tax exempt. Do not include such amount in tax-exempt interest.

If you are completing Part I of Schedule 1 (Form 1040A), include the tax-exempt interest on line 1 only if you received a Form 1099–INT for that interest. Several lines above line 2, put a subtotal of all interest income. Below this subtotal, write "Tax-Exempt Interest" and show the amount of this interest. Subtract this amount from the subtotal and write the remainder on line 2 of Part I. Subtract the amount you figured on Form 8815 on line 3 from the amount on line 2 and enter the result on Line 4 of Schedule 1 and on line 8a of Form 1040A. Be sure to show the tax-exempt interest on line 8b.

Frozen deposits. If you receive a Form 1099–INT for interest on deposits that you could not withdraw at the end of 1990, you can choose to exclude such amounts from your gross income, as explained earlier under *General Information.* If you make this choice, do

not include this income on line 8a. If you are completing Part I of Schedule 1 (Form 1040A), include on line 1 the interest shown on Form 1099–INT. Several lines above line 2, put a subtotal of all interest income. Below this subtotal, write "Frozen Deposits" and show the amount of interest that you are excluding. Subtract this amount from the subtotal and write the result on line 2 of Part I (Schedule 1).

Form 1040

If your taxable interest income is more than $400 or you are claiming the interest exclusion under the Education Savings Bond Program, and you file Form 1040, you must attach a Schedule B to your return and list each payer's name and the amount received from each.

Report on line 1, Part I of Schedule B (Form 1040), all taxable interest you received, including seller-financed mortgage interest. Include the total amount of interest income that is shown in Box 1 and Box 3 of any Form 1099–INT or in Box 1 and Box 2 of any Form 1099–OID that you receive for the tax year, and other interest income received for which you did not receive a Form 1099. List each payer's name and the amount of interest received from each. If you receive a Form 1099–INT or Form 1099–OID from a brokerage firm, list the brokerage firm as the payer. You must also complete Part III of Schedule B (Form 1040). See *Foreign financial accounts and foreign trusts*, discussed in Chapter 1.

If you redeemed Series EE U.S. Savings Bonds and you have qualified educational expenses, complete and attach Form 8815. Enter the result from line 14 of Form 8815 on line 3 of Schedule B. See *Education Savings Bond Program* and *Form 8815* earlier for more information.

Tax-exempt interest income. If you received any tax-exempt interest income (such as interest on certain state and municipal bonds), you must report the total amount of that interest on line 8b of Form 1040. Also report on line 8b any exempt-interest dividends that you received from a mutual fund or other regulated investment company. Do not include this interest in your taxable interest income on line 8a. If you are completing Part I of Schedule B (Form 1040), report tax-exempt interest on line 1 only if you received a Form 1099–INT for that interest. Several lines above line 2, put a subtotal of all interest income listed on line 1. Below this subtotal, write "Tax-Exempt Interest" and show the amount of interest that you are excluding. Subtract this amount from the subtotal and enter the remainder on line 2. Be sure to also show the tax-exempt interest on Form 1040, line 8b.

Interest earned on an individual retirement arrangement (IRA) is tax deferred rather than tax exempt. Do not include such amount in tax-exempt interest.

Frozen deposits. If you receive a Form 1099–INT for interest on deposits that you could not withdraw at the end of 1990, you can choose to exclude such amounts from your gross income, as explained earlier under *General Information*. If you make this choice, do not include this income on line 8a. If you are completing Part I of Schedule B (Form 1040), include the full amount of interest shown on your Form 1099–INT on line 1, Part I of Schedule B (Form 1040). Several lines above line 2, put a subtotal of all interest income. Below this subtotal, write "Frozen Deposits" and show the amount of interest that you are excluding. Subtract this amount from the subtotal and write the remainder on line 2, Part I of Schedule B (Form 1040).

Nominee distributions and accrued interest. If the total interest income you list on line 1, Part I of Schedule B (Form 1040), includes any amount that you received as a nominee for the real owner or that reflects accrued interest paid on a bond that you bought between interest payment dates, show such an amount separately below a subtotal of all interest income listed. Identify the amount as "Nominee Distribution," or "Accrued Interest," as appropriate, and subtract it from the interest income subtotal. Report the remainder on line 2, Part I of Schedule B (Form 1040), and also on Form 1040, line 8a.

Interest on a joint account. If you receive a Form 1099–INT which shows your taxpayer identification number and names 2 or more recipients or includes amounts belonging to another person, you must file a Form 1099–INT with the IRS to show the proper distributions of the amounts shown. Complete Form 1099–INT, and **Form 1096,** *Annual Summary and Transmittal of U.S. Information Returns*, and file both forms with your Internal Revenue Service Center. Give the other person(s) Copy B of the Form 1099–INT which you filed as a nominee. On Form 1099–INT and Form 1096, you should be listed as the "Payer." Prepare one Form 1099–INT for each other owner and show that person as the "Recipient." You are not required, however, to file Form 1099–INT to show payments for your spouse. For more information about the reporting requirements and the penalties for failure to file (or furnish) certain information returns, see *1990 Instructions for Forms 1099, 1098, 5498, and W–2G.*

Example. You receive a Form 1099–INT for 1990 that shows a total of $1,500 of interest income earned on a savings account that you hold jointly with your sister. You each have agreed to share the yearly interest income in proportion to the amount that each of you has invested, even though your identification (social security) number was submitted to the bank for its recordkeeping purposes. Your sister has deposited 30% of the amount invested in this account. As a result, you are considered to be a nominee on behalf of the amount of interest income belonging to your sister. For 1990, this amount is $450, or 30% of the total interest of $1,500.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code	Payer's RTN (optional)	OMB No. 1545-0112 **1990** Statement for Recipients of	**Interest Income**
PAYER'S Federal identification number / RECIPIENT'S identification number	1 Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc. $		**Copy B For Recipient** This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction will be imposed on you if this income is taxable and the IRS determines that it has not been reported.
RECIPIENT'S name / Street address / City, state, and ZIP code / Account number (optional)	2 Early withdrawal penalty $	3 U.S. Savings Bonds, etc. $	
	4 Federal income tax withheld $		
	5 Foreign tax paid $	6 Foreign country or U.S. possession	

Form **1099-INT** Department of the Treasury - Internal Revenue Service

You must provide your sister with a Form 1099–INT no later than January 31, 1991, showing $450 of interest income that she earned for 1990. You must also send a copy of the nominee Form 1099–INT, along with Form 1096, to the Internal Revenue Service Center no later than February 28, 1991. Show your own name, address, and identification number as that of the "Payer" on the Form 1099–INT. Provide the same information for your sister in the blocks provided for identification of the "Recipient."

When you prepare your own 1990 federal income tax return, report the total amount of interest income, $1,500, on line 1, Part I of Schedule B (Form 1040), and identify the name of the bank which paid this interest. Show the amount belonging to your sister, $450, as a subtraction from the subtotal of all interest on Schedule B and identify this subtraction as a "Nominee Distribution." (Your sister will report the $450 of interest income on her own tax return, if she is required to file a return, and identify you as the payer of that amount.)

Original issue discount (OID). If you are reporting OID in an amount greater or less than the amount shown on Form 1099–OID, or other written statement (such as for a REMIC regular interest), include the full amount of OID shown on your Form 1099–OID or other statement on line 1, Part I of Schedule B (Form 1040). If the OID to be reported is less than the amount shown on Form 1099–OID, follow the above reporting rules for nominee distributions or accrued interest, as applicable, so that you will report only the OID you are required to report. Below the subtotal, write "OID Adjustment" and show the OID you are not required to report. If the OID to be reported is greater than the amount shown on Form 1099–OID, show the additional OID separately below a subtotal of all interest income listed. Identify the amount as "OID Adjustment" and add it to the interest income subtotal.

Market discount. Report as interest any gain on the sale (or other disposition) of certain market discount bonds, to the extent of the accrued market discount. See *Market discount bonds*, under *Original Issue Discount (OID)* earlier.

Penalty on early withdrawal of savings. If you withdrew funds from a time savings account before maturity, you may be charged a penalty. You must report the gross amount of interest paid or credited to your account during the year, without subtracting the penalty. You deduct the penalty on line 28, Form 1040. Deduct the entire penalty even if it exceeds your interest income. The Form 1099–INT or similar statement given to you by the financial institution will show the gross amount of interest and the penalty.

The sample return in Chapter 37 has an example on reporting interest income on Form 1040A. The sample return in Chapter 38 has an example on reporting interest income on Form 1040.

9. Dividends and Other Corporate Distributions

Important Reminders

Child's income reported on parent's return. You may choose to include your child's investment income on your tax return if certain requirements are met. If you make this choice, your child is not required to file a return.

Dividends received in January. Any dividend declared by a regulated investment company (mutual fund) or real estate investment trust (REIT) in October, November, or December and payable to you in such a month, but actually paid during January of the following calendar year, is treated as paid to you in the earlier year.

Dividends are distributions of money, stock, or other property paid to you by a corporation. You also may receive dividends through a partnership, an estate, a trust, or an association that is taxed as a corporation. However, some amounts you receive that are called dividends are actually interest income. See *Dividends that are actually interest* under *Taxable Interest* in Chapter 8.

You may receive any of the following kinds of distributions:

Ordinary dividends

Capital gain distributions

Nontaxable distributions

Most distributions that you receive are paid in cash (check). However, you may receive additional stock, stock rights, other property, or services.

Passive activity income and losses. There are tax rules which limit the amount of losses and tax credits from passive activities that you can claim. Generally, only income from passive activities can be used to offset losses from passive activities. Consequently, you generally cannot use passive activity losses to offset your other income, such as your wages or your ***portfolio income*** (that is, any gross income from interest, dividends, etc., that is not derived in the ordinary course of a trade or business). For more information about determining and reporting income and losses from passive activities, see Publication 925, *Passive Activity and At-Risk Rules.*

Tax on investment income of a child under age 14. If a child is under age 14 at the end of the year and has more than $1,000 of investment income (such as taxable interest and dividends), part of his or her investment income may be taxed at the parents' tax rate if either parent is alive at the end of the year. If these requirements are met, **Form 8615,** *Tax for Children Under Age 14 Who Have Investment Income of More Than $1,000,* must be completed and attached to the child's tax return. If these requirements are not met, Form 8615 is not required and the child's income is taxed at his or her own tax rate.

However, parents can choose to include their child's gross income on their return if certain requirements are met. **Form 8814,** *Parent's Election To Report Child's Interest and Dividends,* is used for this purpose.

For more information about the tax on investment income of children and the parent's election, see Chapter 32.

Beneficiary of an estate or trust. Interest, dividends, or other investment income you receive as a beneficiary of an estate or trust is generally taxable income. You should receive a **Schedule K–1** (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.—1990,* from the fiduciary. Your copy of Schedule K–1 and its instructions will tell you where to report the items from Schedule K–1 on your Form 1040.

Backup withholding. To ensure that income tax is collected on dividends and other types of income that generally are not subject to withholding, backup withholding will apply in certain circumstances.

Under backup withholding, when you open a new account you must certify under penalties of perjury that your social security number is correct and that you are not subject to backup withholding. If you fail to make this certification, backup withholding may begin immediately on your new account or investment and 20% of the amount paid on your account or investment will be withheld. Your payer will give you a **Form W–9,** *Request for Taxpayer Identification Number and Certification,* or a similar form, to make this certification. Backup withholding may also be required if the Internal Revenue Service (IRS) has determined that you underreported your interest and dividend income. For more information, see *Backup Withholding* in Chapter 5.

Form 1099–DIV. Most corporations use Form 1099–DIV, *Statement for Recipients of Dividends and Distributions,* or a similar statement, to show you the distributions you received from them during the year. Keep this form with your records. You do not have to attach it to your tax return. Even if you do not receive Form 1099–DIV, you must report all of your taxable dividend income.

Reporting tax withheld. If tax is withheld from your dividend income, the payer must give you a Form 1099–DIV that indicates the amount withheld.

Nominees. If someone receives distributions as a nominee for you, that person will give you a Form 1099–DIV, which will show distributions they received on your behalf.

If you receive a Form 1099–DIV that includes amounts belonging to another person, see *Nominees,* later, under *How to Report Dividend Income,* for more information.

Form 1099–MISC. Certain substitute payments in lieu of dividends or tax-exempt interest that are received by a broker on your behalf must be reported to you on Form 1099–MISC, *Statement for Recipients of Miscellaneous Income,* or a similar statement. See *Reporting substitute payments* under *Short Sales* in Publication 550, *Investment Income and Expenses,* for more information about reporting such substitute payments.

Incorrect amount. If you receive a Form 1099 that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The corrected Form 1099 you receive will be marked "CORRECTED."

Accuracy-related penalties. For returns due after 1989, a 20% accuracy-related penalty may be charged for underpayments of tax due to negligence or disregard of rules and regulations or substantial understatement of tax. For more information on the penalty and any applicable interest, see *Penalties* in Chapter 1.

Social security number. You must give your name and social security number to any person required by federal tax law to make a return, statement, or other document that relates to you. This includes payers of dividends. If you are married and the funds in a joint account belong to you, you should give your social security number to the payer of the dividends. If the funds in the account belong to both you and your spouse, you may give either your number or your spouse's number, as long as the number you provide corresponds with the name listed on the account. You must give the payer the correct social security number if the number being used is wrong.

If you do not give your social security number to the payer of dividends, you may have to pay a penalty. See *Penalty for failure to supply social security number* under *Penalties* in Chapter 1. Backup withholding also may apply. See *Backup Withholding* in Chapter 5.

Dividends received in January. If a regulated investment company (mutual fund) or real estate investment trust (REIT) declares a dividend (including any exempt-interest dividend) in October, November, or December and that dividend is payable to you on a specified date in such month, you are considered to have received the dividend on December 31 even though the company or trust actually pays the dividend during January of the following calendar year. Therefore, you report the amount in the year of declaration.

Ordinary Dividends

Ordinary (taxable) dividends are the most common type of distribution from a corporation. They are paid out of the earnings and profits of a corporation and are ordinary income to you. Any dividend you receive, whether on common or preferred stock, is an ordinary dividend unless the paying corporation tells you otherwise.

Money market funds. Report amounts you receive from money market funds as dividend income. These amounts generally are not interest income and should not be reported as interest.

Dividends on capital stock. Dividends on the capital stock of organizations, such as savings and loan associations, are ordinary dividends. They are not interest. You should report them with your dividend income.

Stock certificate in two or more names. If two or more persons, such as a husband and wife, hold stock as ***joint tenants, tenants by the entirety, or tenants in common,*** each person receives a share of any dividends from the stock. Each person's share is determined by local law.

Dividends used to buy more stock. The corporation in which you own stock may have a ***dividend reinvestment plan.*** This plan lets you choose to use your dividends to buy more shares of stock in the corporation instead of receiving the dividends in cash. If you are a member of this type of plan and you buy the stock at a price equal to the fair market value of the stock, you must report the cash dividends as income.

If you are a member of a dividend reinvestment plan that lets you buy the stock at a price less than the fair market value of the stock, you must report as income the fair market value of the stock on the dividend payment date. You also must report as income any service charge subtracted from your cash dividends before the dividends are used to buy the stock. But, you may be able to deduct the service charge amount. See Chapter 30 for more information about deducting expenses of producing income.

In some dividend reinvestment plans, you can invest additional cash to buy shares of stock at a price less than fair market value. If you choose to do this, you must report as income the difference between the cash you invest and the fair market value of the stock you buy. When figuring this income amount, use the fair market value of the stock on the dividend payment date.

Public utility stock reinvestment plans. If you own stock in a qualified domestic public utility and chose to receive your dividends in common stock, rather than in cash, you must include in your gross income the total value of such stock dividends.

Pre-1986 stock dividend exclusion. A stock dividend exclusion for reinvestment in public utility stock was allowable for distributions of such stock dividends (in lieu of cash dividends) that were made after 1981 and before 1986.

If you chose to exclude the value of the stock dividend from income, before 1986, you were required to exclude it on your return for the year in which you would have included the dividends in income. If you decide to change your choice, you may do so only with the permission of the IRS.

If you excluded from income the value of stock you received under a qualified public utility reinvestment plan, your basis in that stock is zero.

Capital Gain Distributions

These distributions or dividends are paid by ***regulated investment companies, mutual funds, and real estate investment trusts*** from their net realized long-term capital gains. A Form 1099–DIV or the mutual fund statement will tell you the amount you are to report as a capital gain distribution. Report capital gain distributions as long-term capital gains on your tax return regardless of how long you have owned the stock in the mutual fund. Those distributions that are not derived in the ordinary course of a trade or business are treated as portfolio income and are not considered as income from a passive activity (see *Passive activity income and losses*, earlier).

Undistributed capital gains. Some mutual funds keep their long-term capital gains and pay taxes on those amounts. You must report as long-term capital gains any amounts that the mutual fund allocated to you as capital gain distributions, even though you did not actually receive them. (This income is not reported to you on Form 1099–DIV.)

Form 2439. If the investment company or mutual fund has paid a tax on the capital gain, you are allowed a credit for the tax, since it is considered paid by you. The company or fund will send you Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*, showing the amount of the undistributed long-term capital gain and the tax that was paid. Take this credit by entering the amount of tax shown on Form 2439 on line 61, Form 1040. Attach Copy B of Form 2439 to your return.

Basis adjustment. Increase your basis in the stock by the difference between the amount of undistributed capital gain that you report and the amount of the tax paid for you by the fund. Keep Copy C of Form 2439 as part of your records to show increases in the basis of your stock.

Note. You must report any undistributed long-term gains shown on Form 2439 in addition to any capital gain distributions reported on Form 1099–DIV.

Real estate investment trusts (REITs). You will receive a Form 1099–DIV or similar statement from the REIT showing the capital gain distributions you must include in your income. You report the capital gain distributions as long-term capital gain regardless of how long you owned stock in the REIT.

For more information on the treatment of distributions from mutual funds and regulated investment companies, see Publication 564, *Mutual Fund Distributions.*

Nontaxable Distributions

You may receive a return of capital or a tax-free distribution of additional shares of stock or stock rights. These distributions are not treated the same as ordinary dividends or capital gain distributions.

Return of Capital

A return of capital is a distribution that is not paid out of the earnings and profits of a corporation. It is a return of your investment in the stock of the company. You should receive a Form 1099–DIV or other statement from the corporation showing you what part of the distribution is a return of capital. If you do not receive such a statement, you report the distribution as an ordinary dividend.

A return of capital reduces the basis of your stock and is not taxed until your basis in the stock is fully recovered. When the basis of your stock has been reduced to zero, report any return of capital that you receive as a capital gain. Whether you report it as a long-term capital gain or short-term capital gain depends on how long you have held the stock. See *Holding Period* in Chapter 16.

Example. You bought stock in 1985 for $100. In 1987, you received a return of capital of $80. You did not include this amount in your income, but you reduced the basis of your stock. Your stock now has an adjusted basis of $20. You receive a return of capital of $30 in 1990. You use $20 of this amount to reduce your basis to zero. You report the other $10 as a long-term capital gain for 1990. You must report as a long-term capital gain any return of capital you receive on this stock in later years.

Liquidating distributions. Liquidating distributions, sometimes called liquidating dividends, are distributions you receive during a partial or complete liquidation of a corporation. These distributions are, at least in part, one form of a return of capital. They may be paid in one or more installments. You will receive Form 1099–DIV from the corporation showing you the amount of the liquidating distribution.

Any liquidating distribution you receive is not taxable to you until you have recovered the basis of your stock. After the basis of your stock has been reduced to zero, you must report the liquidating distribution as a capital gain (except in certain instances with regard to collapsible corporations). Whether you report the gain as a long-term capital gain or short-term capital gain depends on how long you have held the stock. See *Holding Period* in Chapter 16.

If you acquired stock in a corporation at several different times, you own more than one block of stock in the corporation. If you receive distributions from the corporation in complete liquidation, you must divide the distribution among the blocks of stock you own in the following proportion: the number of shares in that block over the total number of shares you own. Divide distributions in partial liquidation among that part of the stock that is redeemed in the partial liquidation. After the basis of a block of stock is reduced to zero, you must report the part of any later distribution for that block as a capital gain.

If the total liquidating distributions you receive are less than the basis of your stock, you may have a capital loss. You may report a capital loss only after you have received the final distribution in liquidation that results in the redemption or cancellation of the stock. Whether you report the loss as a long-term or short-term capital loss depends on how long you held the stock. See *Holding Period* in Chapter 16.

Distributions of Stock and Stock Rights

Distributions by a corporation of its own stock are commonly known as stock dividends. Stock rights are distributions by a corporation of rights to subscribe to the corporation's stock. Generally, stock dividends and stock rights are not taxable to you, and you do not report them on your return.

Taxable stock dividends and stock rights. Distributions of stock dividends and stock rights are taxable to you if:

1) You or any other shareholder has the choice to receive cash or other property instead of stock or stock rights,
2) The distribution gives cash or other property to some shareholders and an increase in the percentage interest in the corporation's assets or earnings and profits to other shareholders,
3) The distribution is in convertible preferred stock and has the same result as in (2),
4) The distribution gives preferred stock to some common stock shareholders and gives common stock to other common stock shareholders, or
5) The distribution is on preferred stock. (This requirement, however, does not apply if the distribution is made for convertible preferred stock solely to take into account a stock dividend, stock split, or a similar event that would otherwise result in reducing the conversion right.)

In addition, any transaction having the effect of increasing your proportionate interest in the corporation's assets or earnings and profits may be taxable to you, even though no stock or stock rights are actually distributed.

Basis. If you receive taxable stock dividends or stock rights, include their fair market value at the time of the distribution in your income. This amount is your basis in the stock or stock rights received. If you receive stock dividends or stock rights that are not taxable to you, see *Stocks and Bonds* under *Basis of Investment Property* in Publication 550 for information on how to figure the basis of the stock dividends or stock rights you receive.

Fractional shares. You may not own enough stock in a corporation to receive a full share of stock if the corporation declares a stock dividend. However, with the approval of the shareholders, the corporation may set up a plan in which no fractional shares are issued, but are sold, and the cash proceeds are given to the shareholders. Any cash you receive for fractional shares under such a plan is treated as an amount realized on the sale of the fractional shares. You must determine your gain or loss and report it as a capital gain or loss on Schedule D (Form 1040). Your gain or loss is the difference between the cash you receive and the basis of the fractional shares sold.

Example. You own one share of common stock that you bought on January 3, 1989, for $100. The corporation declared a common stock dividend of 5% on June 30, 1990. The fair market value of your stock at the time the stock dividend was declared was $200. You were paid $10 for the fractional-share stock dividend under a plan described in the above paragraph. You figure your gain or loss as follows:

Fair market value of old stock	$200.00
Fair market value of stock dividend (cash received)	10.00
Fair market value of old stock and stock dividend	$210.00
Basis (cost) of old stock after the stock dividend (($200 ÷ $210) × $100)	$ 95.24
Basis (cost) of stock dividend (($10 ÷ $210) × $100)	4.76
Total	$100.00
Cash received	$ 10.00
Basis (cost) of stock dividend	4.76
Gain	$ 5.24

Because you had held the share of stock more than one year at the time the stock dividend was declared, your gain on the stock dividend is a long-term capital gain.

Other Distributions

You may receive any of the following distributions during the year.

Exempt-interest dividends you receive from a regulated investment company (mutual fund) are not included in your taxable income. (However, see *Information reporting requirement,* next.) You will receive a notice from the mutual fund telling you the amount of the exempt-interest dividends you received. Exempt-interest dividends are not shown on Form 1099–DIV or Form 1099–INT. See *Gains and Losses* in Publication 564 for information about the loss treatment of mutual fund stock on which you received exempt-interest dividends.

Information reporting requirement. Although these dividends are not taxable, you must show them on your tax return if you are required to file. This is an information reporting requirement and does not convert exempt-interest dividends to taxable income. See *How to Report Interest Income* in Chapter 8.

Also, exempt-interest dividends may be treated as tax-exempt interest from private activity bonds, which is a "tax preference item" that may be subject to the alternative minimum tax. See *Alternative Minimum Tax* in Chapter 31 for more information.

Dividends on insurance policies are a partial return of the premiums you paid. Do not include them in your gross income until they are more than the total of all net premiums you paid for the contract. However, you must report as taxable income the interest paid or credited on dividends that are left with an insurance company. See Chapter 8 for treatment of interest income.

Dividends on veterans' insurance are not taxable. However, you must report as taxable income interest on dividends left with the Department of Veterans Affairs. See *Veterans* in Chapter 6 for more information about veterans' benefits.

Patronage dividends. Patronage dividends you receive in money from a cooperative organization are generally included in your income.

Do not include in your income patronage dividends you receive on:

1) Property bought for your personal use, or
2) Capital assets or depreciable property bought for use in your business. But you must reduce the basis (cost) of the items bought. If the dividend is more than the adjusted basis of the assets, you must report the excess as income.

These rules are the same whether the cooperative paying the dividend is a taxable or tax-exempt cooperative.

Alaska Permanent Fund Dividends. Do not report these amounts as dividends. Instead, report these amounts on line 22 of Form 1040.

How to Report Dividend Income

Generally, you may use either Form 1040 or Form 1040A to report your dividend income. However, you must use Form 1040 if you receive capital gain distributions or return of capital distributions. If you receive any dividend income, you may not use Form 1040EZ.

Form 1099–DIV. If you owned stock on which you received more than $10 gross dividends and other distributions, you should receive a Form 1099–DIV.

Box 1a of Form 1099–DIV shows the amount of gross dividends and other distributions you received on stock.

Box 1b of Form 1099–DIV shows your ordinary dividends. This amount is included in Box 1a. If you do not need to file Schedule B (Form 1040), or Schedule 1 (Form 1040A), enter the amount shown in Box 1b and any investment expenses shown in Box 1e on line 9 (Form 1040 or Form 1040A).

Box 1c of Form 1099–DIV shows your capital gain distributions. You report these capital gains on line 5 of Schedule B (Form 1040). You cannot file Form 1040A. Since these capital gains are included in the amount shown in Box 1a of Form 1099–DIV, they are entered on line 5 of Schedule B and subtracted out on line 7 of Schedule B. These capital gains are also reported on either line 13, Part II of Schedule D (Form 1040) or, if you do not need to complete

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code		1a Gross dividends and other distributions on stock (Total of 1b, 1c, 1d, and 1e) $	OMB No. 1545-0110 **1990** Statement for Recipients of	**Dividends and Distributions**
		1b Ordinary dividends $		
PAYER'S Federal identification number	RECIPIENT'S identification number	1c Capital gain distributions $	1d Nontaxable distributions $	**Copy B For Recipient**
RECIPIENT'S name		1e Investment expenses $	2 Federal income tax withheld $	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this dividend income is taxable and the IRS determines that it has not been reported.
Street address		3 Foreign tax paid $	4 Foreign country or U.S. possession	
City, state, and ZIP code		**Liquidation Distributions**		
Account number (optional)		5 Cash $	6 Noncash (Fair market value) $	

Form **1099-DIV** Department of the Treasury - Internal Revenue Service

Schedule D, report them directly on line 14 of Form 1040.

Box 1d of Form 1099–DIV shows your nontaxable distributions. Since this amount is included in the amount shown in Box 1a of Form 1099–DIV, it is entered on line 5 of Schedule B (Form 1040) and subtracted out on line 8 of Schedule B. Amounts shown are usually a return of capital that reduces your basis in the stock. Once you have received an amount equal to your cost or other basis, these distributions are taxable to you as a capital gain even if the payer lists them as nontaxable.

If you own stock in a nonpublicly offered regulated investment company, your pro rata share of that fund's allocable investment expenses is shown in Box 1e of Form 1099–DIV. This amount is also included in Box 1a of Form 1099–DIV. You can deduct these expenses as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit only if you itemize on Schedule A (Form 1040).

If you were subject to backup withholding because, for example, you failed to furnish your social security number to a payer, the amount withheld will be shown as federal income tax withheld in Box 2 of Form 1099–DIV. Report this amount on Form 1040A, line 20a, or on Form 1040, line 55.

Box 3 of Form 1099–DIV shows the amount of foreign taxes withheld (paid) on dividends and other distributions, and Box 4 identifies the foreign country or U.S. possession that did the withholding. If there are entries in these boxes, fill out Form 1040 and **Form 1116,** *Foreign Tax Credit.* However, do not complete Form 1116 if you claim this amount as other taxes on Schedule A. For more information on the credit and deduction, see Publication 514.

Box 5 of Form 1099–DIV shows distributions of cash from corporations in partial or complete liquidation, and Box 6 shows the fair market value of noncash distributions. If there are entries in these boxes, see *Liquidating distributions* under *Dividends and Other Corporate Distributions* in Publication 550.

Dividends received on restricted stock. Restricted stock is stock that you get from your employer for services you perform and that is nontransferable and subject to a substantial risk of forfeiture. You do not have to include the value of the stock in your income when you receive it. However, if you get dividends on restricted stock, you must include them in your income as wages, not dividends.

Your employer should include these dividends in the wages shown on your Form W–2. If you also get a Form 1099–DIV for these dividends, list them on line 5, Part II of Schedule B (Form 1040), with the other dividends you received. Enter a subtotal of all your dividend income several lines above line 6. Below the subtotal, write "Dividends on restricted stock reported as wages on line 7, Form 1040," and enter the amount of the dividends included in your wages on line 7, Form 1040. Subtract this amount from the subtotal and enter the remainder on line 6, Part II of Schedule B.

Election. You can choose to include in gross income the value of restricted stock as compensation for services. If you make this choice, the dividends are treated as any other dividends.

If you receive both a Form 1099–DIV and a Form W–2 showing these dividends, do not include the dividends in your wages reported on line 7, Form 1040. List the dividends on line 5, Part II of Schedule B, along with your other dividends. Attach a statement to your Form 1040 explaining why the amount shown on line 7 of your Form 1040 is different from the amount shown on your Form W–2.

Dividends on stock sold. If stock is sold, exchanged, or otherwise disposed of after a dividend is declared, but before it is paid, the owner of record (usually the payee shown on the dividend check) must report the dividend. Even if the purchase price of the stock goes up because of the amount of the anticipated dividend, the owner of record must report such dividend.

Stock sold short. If you borrow stock to make a short sale, you may have to pay the lender an amount in lieu of the dividends distributed while you maintain your short position. Your treatment of the payment depends on the kind of distribution for which you are reimbursing the lender of the stock.

If your payment is made for a liquidating distribution or nontaxable stock distribution, or if you buy more shares equal to a stock distribution issued on the borrowed stock during your short position, you have a capital expense. You must add the payment to the cost of the stock sold short. See *Short Sales* in Publication 550 for more information about the tax treatment of short sales.

Expenses related to dividend income. You may deduct expenses related to dividend income only if you itemize your deductions on Schedule A (Form 1040). See Chapter 30 for general information about deducting expenses of producing income.

Form 1040A

Report your total dividends on line 9, Form 1040A. If the amount on line 9 is more than $400, you also must list each payer's name and the amount of dividends received from each payer in Part II of Schedule 1 (Form 1040A) and attach it to your Form 1040A. If you received a Form 1099–DIV from a brokerage firm, list the brokerage firm as the payer. However, you must use Form 1040 instead of Form 1040A if you had capital gain distributions or return of capital distributions. (Exempt-interest dividends, which are treated as interest, should be reported on line 8b. See *How to Report Interest Income* in Chapter 8.)

Nominees. If you received dividends as a nominee (that is, the dividends are in your name but actually belong to someone else),

include them on line 5 of Schedule 1. Several lines above line 6, put a subtotal of all dividend income listed on line 5. Below this subtotal, write "Nominee Distribution" and show the amounts received as a nominee. Subtract the total of your nominee distributions from the subtotal. Enter the result on line 6 of Part II.

See *Nominees*, later, for more information.

Form 1040—Total Dividends and Other Distributions of $400 or Less

If your total dividends, including capital gain and nontaxable distributions, are $400 or less, report only the total of your ordinary dividends from Box 1b of Form 1099–DIV and any investment expenses from Box 1e of Form 1099–DIV on line 9, Form 1040.

Capital gain distributions. Report capital gain distributions (Box 1c of Form 1099–DIV) on line 13, Part II of Schedule D (Form 1040). If you do not need Schedule D to report any other capital gains or losses, enter your capital gain distributions on line 14, Form 1040.

Nontaxable (return of capital) distributions. Some distributions are nontaxable because they are a return of your cost. You report return of capital distributions (Box 1d of Form 1099–DIV) as capital gain only when your basis in the stock has been reduced to zero. If the basis of your stock is zero, report any return of capital distributions you receive on line 2d, Part I of Schedule D, if you held the stock one year or less, or on line 9d, Part II of Schedule D, if you held the stock for more than one year.

Form 1040—Total Dividends and Other Distributions of More Than $400

If your total dividends, including capital gain and nontaxable distributions, are more than $400, you must fill in Schedule B and attach it to your return. You must complete Parts II and III of Schedule B.

You must report all of your dividend income (Box 1a of Form 1099–DIV) on line 5, Part II of Schedule B. You must include on this line all the ordinary dividends, capital gain distributions, and return of capital distributions you receive. You should list the name of the payer and the amount of income for each distribution you receive. If your securities are held by a brokerage firm (in "street name"), list the name of the brokerage firm that is shown on Form 1099–DIV as the payer. If your stock is held by a nominee who is the owner of record, and the nominee credits or pays you dividends on the stock, you should show the name of the nominee and the dividends you received or for which you were credited. You should enter on line 6 the total of the amounts listed on line 5. However, if you hold stock as a nominee, see *Nominees*, later.

Capital gain distributions. You enter on line 7, Part II of Schedule B, any amount shown on line 5 that is a capital gain distribution. You also enter this amount on line 13, Part II of Schedule D (Form 1040). If you do not need to use Schedule D to report any other gains or losses, do not use it. Instead, show your capital gain distributions on line 14, Form 1040.

Nontaxable (return of capital) distributions. You enter on line 8, Part II of Schedule B, any amount from line 5 that you received as a return of capital distribution. However, after the basis of your stock has been reduced to zero, you must also show this amount on line 2d, Part I of Schedule D, if you held the stock one year or less, or on line 9d, Part II of Schedule D, if you held the stock for more than one year.

Completing Schedule B. Add the amounts shown on lines 7 and 8 and enter the total on line 9. Subtract the amount on line 9 from the amount on line 6. The difference, if any, is your taxable ordinary dividends. Enter this amount on line 10, Part II of Schedule B, and on line 9, Form 1040. You must also complete Part III of Schedule B. See *Foreign financial accounts and foreign trusts* under *Additional Schedules* in Chapter 1 for more information.

Nominees. Include on line 5, Part II of Schedule B (Form 1040), all dividends you received. This includes dividends you received, as a nominee, that actually belong to another person (such as your child), even if you later distributed some or all of this income to others. Enter a subtotal of all your dividend income listed on line 5 several lines above line 6. Below the subtotal, write "Nominee Distribution" and show the amounts received as a nominee. Subtract these distributions from the subtotal and enter the remainder on line 6.

If you receive a Form 1099–DIV on which your taxpayer identification number is shown, and 2 or more recipients are named, or amounts belonging to another person are included, you must file a Form 1099–DIV with the IRS to show the proper distributions of the amounts shown. Complete a **Form 1096,** *Annual Summary and Transmittal of U.S. Information Returns*, and file both forms with the Internal Revenue Service Center. Give the other person Copy B of the Form 1099–DIV which you filed as a nominee. On Form 1099–DIV and Form 1096, you should be listed as the "Payer." On Form 1099–DIV, the other owner should be listed as the "Recipient." You are not required, however, to file a Form 1099–DIV to show payments for your spouse. For more information about the reporting requirements and the penalties for failure to file (or furnish) certain information returns, see *1990 Instructions for Forms 1099, 1098, 5498, and W-2G.*

Liquidating distributions. You will receive Form 1099–DIV from the corporation showing the amount of the liquidating distribution. Generally, this is treated as the sale or exchange of a capital asset and should be reported on Schedule D (Form 1040).

The sample return in Chapter 37 has an example on reporting dividend income on Form 1040A. The sample return in Chapter 38 has an example on reporting dividend income on Form 1040.

10. Rental Income and Expenses

This chapter discusses rental income and expenses, including depreciation. It also explains how to report rental income and expenses on your return.

If you sell or otherwise dispose of your rental property, see Publication 527, *Residential Rental Property.*

If you have a loss from damage to, or from theft of, rental property, see Publication 334, *Tax Guide for Small Business, Chapter 25.*

If you rent out a condominium or a cooperative apartment, some special rules apply to you even though you receive the same tax treatment as other owners of rental property. See Publication 527 for more information.

Rental Income

Rental income is any payment you receive for the use or occupation of property.

You generally must include in your gross income all amounts you receive as rent.

In addition to amounts you receive as normal rent payments, there are other amounts that may be rental income.

Advance rent. Advance rent is any amount you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting you use. Deduct rental expenses when you pay or incur them.

Example. You sign a 10–year lease to rent your property. In the first year, you receive $5,000 as rent for the first year and $5,000 in advance as rent for the last year of the lease. You must include $10,000 in your income in the first year.

Security deposits. Do not include a security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But, if during any year, you keep part or all of the security deposit because your tenant does not live up to the terms of the lease, include the amount you keep in your income for that year.

If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in your income when you receive it.

Payment for canceling a lease. If your tenant pays you to cancel a lease, the amount you receive is rent. Include the payment in your income for the year you receive it whether you use the cash or accrual method of accounting.

Expenses paid by tenant. If your tenant pays any of your expenses, these payments are rental income. You must include them in your income. You can deduct those expenses if they are otherwise deductible.

Property or services. If you receive property or services, instead of money, as rent, include the fair market value of the property or services in your rental income.

If the services are provided at an agreed upon or specified price, that price will be the fair market value in the absence of evidence to the contrary.

Rental of property also used as a home. If you rent property that you also use as your home and you rent it for less than 15 days during the tax year, do not include the rent you receive in your gross income. You cannot deduct expenses other than allowable interest, taxes, and casualty and theft losses. See *Vacation Homes and Other Dwelling Units*, later.

If you own a part interest in rental property, you must report your part of the rental income from the property.

Rental Expenses

This part discusses repairs and certain other expenses of renting property that you ordinarily can deduct from your gross rental income. It includes information on the expenses you can deduct if you rent part of your property, or if you change your property to rental use. Depreciation, which you can also deduct from your gross rental income, is discussed later.

If you own a part interest in rental property, you can deduct your part of the expenses that you paid.

When to deduct. You generally deduct your rental expenses in the year you pay or incur them.

Pre-rental expenses. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent. See *Vacant rental property*, later.

Expenses for rental property sold. If you sell property you held for rental purposes, you can deduct the ordinary and necessary expenses for managing, conserving, or maintaining the property until it is sold.

Vacant rental property. If you hold property for rental purposes, you may be able to deduct your ordinary and necessary expenses for managing, conserving, or maintaining the property while the property is vacant. However, you cannot deduct any loss of rental income for the period the property is vacant.

Repairs and Improvements

You can deduct the cost of repairs that you make to your rental property. You cannot deduct the cost of improvements. You recover the costs of improvements by taking depreciation (explained later).

Separate the costs of repairs and improvements and keep accurate records showing the cost of improvements. You will need to know these costs when you sell or depreciate your property.

Repairs. A repair keeps your property in good operating condition. It does not materially add to the value of your property or substantially prolong its life. Repainting property inside or out, fixing gutters or floors, fixing leaks, plastering, and replacing broken windows are examples of repairs.

If you make repairs as part of an extensive remodeling or restoration of your property, the whole job is an improvement.

Improvements. An improvement adds to the value of your property, prolongs its useful life, or adapts it to new uses. Putting a recreation room in an unfinished basement, paneling a den, adding a bathroom or bedroom, putting decorative grillwork on a balcony, putting up a fence, putting in new plumbing or wiring, putting in new cabinets, putting on a new roof, and paving a driveway are examples of improvements.

If you make improvements to property before you begin renting it, add the cost of the improvement to the basis of the property. Basis is explained later under *Modified Accelerated Cost Recovery System (MACRS)*.

Other Expenses

You can deduct from your gross rental income expenses for advertising, janitor and maid service, utilities, fire and liability insurance, taxes, interest, commissions for the collection of rent, ordinary and necessary travel and transportation, and other expenses discussed below.

Salaries and wages. You can deduct reasonable salaries and wages you pay to your employees. You can also deduct bonuses you pay to your employees if, when added to their regular salaries or wages, the total is not more than reasonable pay.

You can deduct reasonable wages you pay to your dependent child if your child is your bona fide employee. However, you cannot deduct the cost of meals and lodging for the child.

Rental payments for property. You can deduct the rent you pay for property that you use for rental purposes. If you buy a leasehold for rental purposes, you can deduct an equal part of the cost each year over the term of the lease.

Rental of equipment. You can deduct the rent you pay for equipment that you use for rental purposes. However, in some cases, lease contracts are actually purchase contracts. If so, you cannot deduct these payments. You can recover the cost of purchased equipment through depreciation. See *Depreciation*, later.

Insurance premiums. You can deduct insurance premiums you pay. If you pay the premiums for more than one year in advance, each year you can deduct the part of the premium payment that will apply to that year. You continue to deduct your premium in this manner for as long as the insurance is in effect. You cannot deduct the total premium in the year you pay it.

Local benefits. Generally, you cannot deduct charges for local benefits that increase the value of your property, such as for putting in streets, sidewalks, or water and sewer systems. You must add them to the basis of your property. You can deduct local benefit taxes if they are for maintaining, repairing, or paying interest charges for the benefits.

Charges for services. You can deduct charges you pay for providing services for your rental property, such as water, sewer, and trash collection.

Travel and transportation expenses. You can deduct your ordinary and necessary travel expenses when you are traveling away from home, as well as your ordinary and necessary transportation expenses when you are *not* traveling away from home, if the expenses are in connection with the management, conservation, or maintenance of property held by you for rental purposes. See *Limits on Deductions for Rental Expenses*, later. For additional information, see Publication 527.

Renting Part of Your Property

If you rent part of your property, you must divide certain expenses between the part of the property used for rental purposes and the part of the property used for personal purposes as though you actually had two separate pieces of property.

You can deduct a part of some expenses, such as mortgage interest and property taxes, as a rental expense. You can deduct the other part, subject to certain limitations, only if you itemize your deductions. You can also deduct as a rental expense a part of other expenses that normally are nondeductible personal expenses, such as expenses for electricity, a second telephone line, or painting the outside of your house.

You do not have to divide the expenses that relate only to the rental part of your property. If you paint a room that you rent, or if you pay premiums for liability insurance in connection with renting a room in your home, your entire cost is a rental expense. You can deduct depreciation, discussed later, on the part of the property used for rental purposes as well as on the furniture and equipment you use for these purposes.

How to Divide Expenses

If an expense is for both rental use and personal use, such as mortgage interest or heat for the entire house, you must divide the expense between the rental use and the personal use. You can use any reasonable method for dividing the expenses. The two most common methods are one based on the number of rooms in your home and one based on area.

The number of people involved may be the proper method to use to divide certain expenses. For example, if you provide board along with rooms you rent to tenants, the most accurate method of dividing food costs between rental and personal expenses may be one based on the total number of people eating the food. Or, if you rent an apartment and your tenants have unrestricted use of your second telephone line, the number of people using it may be the best method for dividing the monthly charge for the telephone.

Limits on Deductions for Rental Expenses

If you rent out part of your property and you also use that or another part of the same property for personal purposes during the year, your deductions for rental expenses for the property may be limited as discussed later, under *Vacation Homes and Other Dwelling Units*.

Business use of home. If you use part of your home for business (including work as an employee), your deductions for business use of your home are limited. See Publication 587, *Business Use of Your Home*.

Property Changed to Rental Use

If you change your home, apartment, or other property, or a part of it, to rental use at any time other than at the beginning of your tax year, you must divide yearly expenses such as depreciation, taxes, and insurance between rental use and personal use.

You can deduct as rental expenses only the part of the expense that is for the part of the year the property was used or held for rental purposes.

You cannot deduct depreciation or insurance for any property or part of property held for personal use. However, you can deduct the allowable part of the interest and tax expenses for personal use as an itemized deduction on Schedule A (Form 1040).

If you change your property, or a part of it, to rental property, special rules apply for figuring your basis for depreciation. See *Property Changed to Business or Rental Use* in Chapter 15.

Example. You moved from your home in May 1990 and started renting it out on June 1, 1990. You can deduct as rental expenses

seven-twelfths of your yearly expenses such as taxes and insurance.

You can deduct as rental expenses, starting with June, the amounts you pay for items generally billed monthly, such as utilities.

See *Personal home changed to rental use* later under *Modified Accelerated Cost Recovery System (MACRS)* for information about how to figure your deduction for depreciation.

Other limits. If you change property to rental use and later use part or all of it for personal purposes, there are other rules that apply to how much of your rental expenses you can deduct. These rules are explained next under *Vacation Homes and Other Dwelling Units.*

Vacation Homes and Other Dwelling Units

If you rent out part or all of a vacation home or other dwelling unit and you also use any part of the dwelling unit for personal purposes during the year, you must divide your expenses between the rental use and the personal use.

Depending on how your property was used, you may not be able to deduct any of your rental expenses, you may not be able to deduct all of your rental expenses in the year that you pay them, or you may not have to include any of the rent in your income.

Home and main home. The terms ***residence*** and ***principal residence,*** as used in prior editions of this publication, have been replaced with ***home*** and ***main home.***

Main home. If you have more than one home, your main home is the one you live in most of the time.

Dwelling Unit

For purposes of the rules that apply to vacation homes and other dwelling units, a dwelling unit includes a house, apartment, condominium, mobile home, boat, or similar property. It does not include property used exclusively as a hotel, motel, inn, or similar establishment.

Property is used exclusively as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and is not used by an owner as a home during the year.

Used as Home

You use a dwelling unit as a home during the tax year if you use it for personal purposes more than 14 days and more than 10% of the number of days during the year that it is rented at a fair rental price. See *Personal Use,* later, for information on how to determine days of personal use.

To determine whether you use a dwelling unit as a home, do not count any day on which you use it for personal purposes as a day on which it is rented at a fair rental price.

Fair rental price. A fair rental price for your property generally is an amount that a person who is not related to you would be willing to pay. The rent you charge is *not* a fair rental price if it is substantially less than the rents charged for other properties that are similar to your property.

Ask yourself the following questions when comparing another property with yours.

Is it used for the same purpose?

Is it approximately the same size?

Is it in approximately the same condition?

Does it have similar furnishings?

Is it in a similar location?

If any of the answers are no, the properties probably are not similar.

Examples. The following examples show how to determine whether your rental property is a dwelling unit or a hotel, motel, inn, or similar property.

Example 1. You converted the basement of your home into an apartment with a bedroom, a bathroom, and a small kitchen. You rent the apartment to college students during the regular school year. You rent to them on a 9-month (273 days) lease.

During the summer, your nephews stay with you for a month (30 days) and live in the apartment.

Your basement apartment is a dwelling unit (and not a hotel, motel, inn, or similar establishment) because you use it as a home (that is, for personal purposes for more than 14 days and more than 10% of the number of days for which it is rented).

Example 2. You rent out the guest bedroom in your home during the local college's homecoming, commencement, and football weekends (a total of 27 days). Your sister-in-law stays in the room, rent-free, for the last three weeks (21 days) in July.

The room itself is not a dwelling unit, but it is part of a dwelling unit. The room is not used exclusively as a hotel, motel, inn, or similar establishment because you use it as a home (that is, for personal purposes for more than 14 days and more than 10% of the number of days for which it is rented).

Example 3. You rent out a room in your home that is always available for occupancy by paying customers. You do not use the room yourself, and you do not allow anyone other than paying customers to use the room. The room is used exclusively as a hotel, motel, inn, or similar establishment and is therefore not a dwelling unit.

Example 4. You own a cottage at the shore. You rent it out from June 1 through August 31, a total of 92 days. During 1990, the tenant who rented the cottage for the month of July was unable to use it from July 4 through July 8. The tenant allowed you to use the cottage for those 5 days. The tenant did not ask for a refund of or a reduction in the rent. Your family used the cottage for 3 of those days.

For purposes of determining whether you used the cottage as a home during 1990, you do not count those 3 days as days on which the cottage was rented at a fair rental price. The cottage was rented at a fair rental price for 89 days (92 − 3 = 89).

You use the cottage as a home if you use it for personal purposes for more than 14 days.

Personal Use

You use a dwelling unit for personal purposes on any day that it is used by:

1) You or by any other person who has an interest in it, unless it is rented as a main home under a shared equity financing agreement (defined later),
2) A member of your family or by a member of the family of any other person who has an interest in it, unless the family member uses the dwelling unit as his or her main home and pays a fair rental price (Family includes only brothers and sisters, half-brothers and half-sisters, spouses, ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.)),
3) Anyone under an arrangement that lets you use some other dwelling unit, or
4) Anyone at less than a fair rental price.

Rental to person with interest in unit. You use a dwelling unit for personal purposes if you rent it to someone who has an interest in it unless the rental is under a shared equity financing agreement.

Shared equity financing agreement. This is an agreement under which two or more persons acquire undivided interests for more than 50 years in an entire dwelling unit, including the land, and one or more of the co-owners is entitled to occupy the unit as their main home upon payment of rent to the other co-owner or owners.

Rental to family member. You do not use a dwelling unit for personal purposes if you rent it at a fair rental price to a member of your family who uses it as his or her main home (unless he or she has an interest in the unit).

Charitable contributions. You use a dwelling unit for personal purposes if:

You donate the use of the unit to a charitable organization,

The organization sells the use of the unit at a fund-raising event, and

The purchaser uses the unit.

Examples

The following examples show how to determine days of personal use.

Example 1. You and your neighbor are co-owners of a condominium at the beach. You rent the unit out to vacationers whenever possible. The unit is not used as a main home by anyone. Your neighbor uses the unit for two weeks every year.

Because your neighbor has an interest in the unit, both of you are considered to have used the unit for personal purposes during those two weeks.

Example 2. You and your neighbors are co-owners of a house under a shared equity financing agreement. Your neighbors live in the house and pay you a fair rental price.

Even though your neighbors have an interest in the house, the days your neighbors live there are not counted as days of personal use by you. This is because your neighbors rent the house as their main home under a shared equity financing agreement.

Example 3. You own a rental property that you rent to your son. Your son has no interest in this dwelling unit. He uses it as his main home. He pays you a fair rental price for the property.

Your son's use of the property is not personal use by you because your son is using it as his main home, he has no interest in the property, and he is paying you a fair rental price.

Example 4. You rent your beach house to Mary Smith. Mary rents her house in the mountains to you. You each pay a fair rental price.

You are using your house for personal purposes on the days that Mary uses it because your house is used by Mary under an arrangement that allows you to use her house.

Example 5. You rent an apartment to your mother at less than a fair rental price. You are

using the apartment for personal purposes on the days that your mother runs it.

Days Not Counted as Personal Use

Some days you spend at the dwelling unit are not counted as days of personal use.

Repairs and maintenance. Any day that you spend repairing and maintaining your property on a full-time basis is not counted as a day of personal use. Do not count such a day as a day of personal use even if people related to you use the property for recreational purposes on the same day.

Use as home before or after renting. You do not have to count days on which you used the property as your main home as days of personal use if:

1) You used the property as your main home *either* before or after renting it or offering it for rent, *and either*
2) You rented or tried to rent the property for 12 or more consecutive months, *or*
3) You rented or tried to rent the property for a period of less than 12 consecutive months and the period ended because you sold or exchanged the property.

See Publication 527, *Residential Rental Property*, for more information about this situation.

Division of Expenses

If you use a dwelling unit for both rental and personal purposes, you must divide your expenses between the rental use and the personal use. For purposes of dividing your expenses:

1) Any day that the unit is rented at a fair rental price is a day of rental use even if you have personally used the unit for that day, and
2) A unit is *not* considered used for rental during the time that it is held out for rent but not actually rented.

Example. You offer your beach cottage for rent from June 1 through August 31 (92 days). Your family uses the cottage during the last 2 weeks in May (14 days). During 1990, you were unable to find a renter for the first week in August (7 days). The person who rented the cottage for July allowed you to use it over a weekend (2 days) without any reduction in or refund of rent. The cottage was not used at all before May 17 or after August 31.

The cottage was used for rental a total of 85 days (92 − 7 = 85). The days it was held out for rent but not rented (7 days) are not days of rental use. For purposes of dividing expenses, the July weekend on which you used it (2 days) is rental use because you received a fair rental price for the weekend.

You used the cottage for personal purposes for 14 days (the last 2 weeks in May).

Figuring Your Income and Deductions

How you figure your rental income and deductions depends on how much personal use you made of the property and how many days the property was rented.

General Rule

If you do not use a dwelling unit as a home, you divide your expenses between personal use and rental use based on the number of days it was used for each purpose.

Your deductible rental expenses can be more than your gross rental income. However, see *Passive Activity Limits*, later.

Where to report. Report the rental income and all of the rental expenses on Schedule E (Form 1040), *Supplemental Income and Loss*.

You can deduct allowable interest, taxes, and casualty losses for the personal use of the property on Schedule A (Form 1040) if you itemize deductions.

Property Used as a Home

If you use a dwelling unit as a home (as explained earlier), how you figure your rental income and deductions depends on how many days the unit was rented.

Rented less than 15 days. If you use a dwelling unit as a home and you rent it for less than 15 days during the year, you do not report any of the rental income. However, you cannot deduct any expenses as rental expenses.

You can deduct your allowable interest, taxes, and casualty and theft losses on Schedule A (Form 1040) if you itemize deductions.

Rented 15 days or more. If you use a dwelling unit as a home and rent it for 15 days or more during the year, you report all your rental income. You must divide your expenses between the personal use and the rental use based on the number of days used for each purpose. If you had a net profit from the rental property for the year (that is, if your rental income is more than the total of your rental expenses, including depreciation), deduct all of your rental expenses. However, if you did not have a net profit from the rental property, you may not be able to deduct all of your rental expenses.

Note. If you had a *casualty loss* on the rental property during the year, see Publication 527 for information about how to figure your net rental loss.

If you cannot deduct all of your *home mortgage interest* because of the limit on the deduction of home mortgage interest, see Publication 527. The limit on the deduction of home mortgage interest is explained in Chapter 24, under *Mortgage Interest*.

Figuring your loss. If you:

Did not have a net profit for the year from the rental property,

Did not have a casualty loss on the rental property during the year, and

Can deduct all of your mortgage interest paid during the year,

deduct your rental expenses for the year in the following order:

1) Deduct the rental use portion of interest and taxes.
2) Deduct rental expenses that are not directly related to the dwelling unit itself. This includes expenses such as rental agent fees, office supplies, depreciation on office equipment used exclusively in the business of renting property, and advertising fees.
3) Deduct the rental use portion of any expenses not described in (1) or (2) (other than depreciation and other basis adjustments). This includes expenses such as repairs, insurance, and utilities. You can deduct these expenses only if your gross rental income is more than the total of the expenses described in (1) and (2). If these expenses are more than your gross rental income reduced by the expenses described in (1) and (2), deduct only the amount that is equal to your gross rental income reduced by those expenses. See *Carryover of expenses*, later.
4) Deduct the rental use portion of depreciation and other basis adjustments to that rental property. You can deduct depreciation and other basis adjustments only if your gross rental income is more than the total of the deductions in (1), (2), and (3). If your depreciation and other basis adjustments are more than your gross rental income reduced by the total of the expenses in (1), (2), and (3), deduct only the amount that is equal to your gross rental income reduced by those expenses. See *Carryover of expenses*, later.

Where to report. Report your rental income and all your deductible expenses for the rental use on Schedule E (Form 1040). You deduct allowable interest and taxes for the personal use of the property on Schedule A (Form 1040) if you itemize deductions.

Carryover of expenses. If the total of your rental expenses is more than your gross rental income, the expenses that you are not allowed to deduct may be carried forward to the next year and treated as rental expenses for the same property. Any expenses carried forward to next year will be subject to any applicable limits next year. You can deduct the expenses carried over to a year only up to the amount of your rental income for that year, even if you do not use the property as your home for that year.

Not Rented For Profit

If you do not expect to make a profit from the rental of a dwelling unit, you can deduct your rental expenses only up to the amount of your rental income. You must deduct your expenses using the rules explained in Publication 535, *Business Expenses*. You *cannot* carry forward any of your rental expenses that are more than your rental income.

Where to report. You report your rental income on line 22, Form 1040. You claim your deductible rental expenses as a miscellaneous deduction on line 21, Schedule A (Form 1040) if you itemize deductions.

You can deduct most miscellaneous deductions, including these, only to the extent the total is more than 2% of your adjusted gross income. For more information about miscellaneous deductions, see Chapter 30.

Depreciation

Depreciation is the annual deduction you take to recover the cost of rental property that is used for more than one year.

Several factors determine how much depreciation you can deduct. The main factors are: (1) your basis in the property, and (2) the recovery period for the property.

You can deduct depreciation only on the part of your property used for rental purposes. Depreciation reduces your basis for figuring gain or loss on a later sale or exchange. Use Form 4562, *Depreciation and Amortization*, to report your depreciation.

You should claim the correct amount of depreciation each tax year. If you did not deduct depreciation in earlier years, you cannot deduct the unclaimed depreciation in the current or any later tax year. However, you can claim the depreciation on an amended

return (Form 1040X) for the earlier year. See *Amended Returns* in Chapter 1 for more information.

Methods of depreciation. There are now three systems involved in the computation of depreciation. The depreciation system that applies to a particular piece of property is determined by the type of property and when the property was placed in service. For ***tangible property,*** you use:

1) MACRS (or alternate MACRS) if placed in service after 1986,
2) ACRS if placed in service after 1980 but before 1987, or
3) Straight line or an accelerated method of depreciation, such as the declining balance method, if placed in service before 1981.

This chapter discusses MACRS only. If you need information about any other method of depreciation, see Publication 534, *Depreciation.*

Tangible property. Tangible property is any property that you can see or touch. This includes automobiles, buildings, and equipment.

Cannot be more than basis. The total of all your yearly depreciation deductions cannot be more than your cost or other basis of the property. For this purpose, the total depreciation must include any depreciation that you were allowed to claim, even if you did not claim it.

Cooperative apartments. If you are a tenant-stockholder in a cooperative housing corporation and you rent your cooperative apartment to others, you may deduct your share of the corporation's depreciation. See Publication 527, *Residential Rental Property,* for information on how to figure your depreciation deduction.

Modified Accelerated Cost Recovery System (MACRS)

The modified accelerated cost recovery system (MACRS) applies to all tangible property placed in service during 1990.

If you placed your property in service before 1990, continue to use the same method of figuring depreciation that you used in the past.

Personal home changed to rental use. Use MACRS to figure the depreciation on property you used as your home before 1987 and changed to rental property after 1986.

Property Classes Under MACRS

Each item of property that can be depreciated is assigned to a property class. The recovery period of a piece of property depends on the class the property is in. The property classes are:

3-year property,
5-year property,
7-year property,
10-year property,
15-year property,
20-year property,
Nonresidential real property, and
Residential rental property.

The class to which property is assigned is determined by its class life. Class life is discussed in Publication 534.

Optional tables. There are optional percentage tables in Publication 534 that you can use to figure your depreciation under MACRS.

Recovery Periods

Under MACRS, tangible property usually used in rental activities that you placed in service during 1990 falls into one of the following classes. The other recovery classes are discussed in Publication 534.

1) ***5-year property.*** This class includes property with a class life of more than 4 years but less than 10 years, such as computers and peripheral equipment, office machinery (typewriters, calculators, copiers, etc.), automobiles, and trucks.

   Note. Depreciation on automobiles and computers is limited. See *Passenger Automobiles* and *Partial Business Use of Listed Property* in Publication 534.

2) ***7-year property.*** This class includes property with a class life of 10 years or more but less than 16 years, such as office furniture and fixtures (desks, files, etc.). This class also includes any property that does not have a class life and that has not been designated by law as being in any other class.
3) ***15-year property.*** This class includes property with a class life of 20 years or more but less than 25 years. It includes roads and shrubbery (if depreciable).
4) ***Nonresidential real property.*** This class includes:
   - Any real property that is not residential rental property (defined later), and
   - Any real property that is section 1250 property with a class life of 27.5 years or more. See Publication 527 for more information.

   Nonresidential real property is depreciated over 31.5 years.
5) ***Residential rental property.*** This class includes any real property that is a rental building or structure (including mobile homes) for which 80% or more of the gross rental income for the tax year is rental income from dwelling units. If you live in any part of the building or structure, the gross rental income includes the fair rental value of the part you live in. This property is depreciated over 27.5 years.

A dwelling unit is a house or an apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, inn, or other establishment where more than half of the units are used on a transient basis.

Placed in Service

Property is considered placed in service when it is in a condition or state of readiness and availability for use in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity.

Basis

To deduct the proper amount of depreciation each year, you must first determine your basis in the property you intend to depreciate. The basis used for figuring depreciation is your original basis in the property increased by any improvements made to the property. Your original basis is usually the purchase price. However, if you acquire the property in some other way, such as inheriting it, getting it as a gift, or building it yourself, you may have to figure your original basis in another way. Other adjustments could also affect your basis. See Chapter 15.

Figuring MACRS Depreciation

You can figure your MACRS depreciation in one of two ways. You can either:

1) Actually compute the deduction using the applicable depreciation method and convention over the recovery period, or
2) Use the percentage from the optional MACRS tables.

The deduction is the same under both methods.

Depreciation Methods

For property in the 5- or 7-year classes, you use the double (200%) declining balance method over 5 or 7 years and a half-year convention or the mid-quarter convention, if applicable (defined later). For property in the 15-year class, you use the 150% declining balance method over 15 years and a half-year convention.

You can also choose to use the 150% declining balance method over the class life (12 years for personal property with no class life). You make this election by entering "150 DB" in column (f) and "HY" for the half-year convention or "MQ," for the mid-quarter convention, in column (e), Part 2 of Form 4562.

For these classes of property, change to the straight line method for the first tax year for which that method, when applied to the adjusted basis at the beginning of the year, will yield a larger deduction.

You must use the straight line method and a mid-month convention (defined later) for nonresidential real property and residential rental property. Also see *Optional Tables,* later.

Instead of using the declining balance method, you may elect to use the straight line method with a half-year or mid-quarter convention over the recovery period. The election to use the straight line method for a class of property applies to all property in that class that is placed in service during the tax year of the election.

The election is made by entering "S/L" in column (f) and "HY," "MM," or "MQ" in column (e), Part 2 of Form 4562, *Depreciation and Amortization.* Once made, the election to use the straight line method over the recovery period may not be changed (see also *Alternate MACRS Method,* later).

Declining balance method. To figure your MACRS deduction, first determine your declining balance rate of depreciation. This is determined by dividing the specified declining balance percentage (150% or 200%) by the recovery period. For example, for 5-year property, you divide 2.00 (200%) by 5 to get .4 (40%). For 15-year property, you divide 1.5 (150%) by 15 to get .1 (10%).

Multiply the adjusted basis of the property by the declining balance rate, and apply the applicable convention to figure your depreciation for the first year. In later years,

1) Adjust your basis by subtracting the amount of depreciation allowable for the earlier years, then
2) Multiply your adjusted basis by the same rate used in the first year.

Follow steps (1) and (2) each year that you use the declining balance method.

Declining balance rates. The following table shows the applicable declining balance rate for each class of property and the first

year for which the straight line method will give an equal or greater deduction.

Class	Declining Balance Rate	Year
5	40%	4th
7	28.57%	5th
15	10%	7th

Straight line method. To figure your MACRS deduction under the straight line method, you must figure a new depreciation rate for each tax year in the recovery period. For any tax year, figure the straight line rate by dividing the number 1 by the years remaining in the recovery period at the beginning of the tax year. Multiply the unrecovered basis of the property by the straight line rate. You must figure the depreciation for the first year using the applicable convention (see *Conventions*, later). If the remaining recovery period at the beginning of the tax year is less than 1 year, the straight line rate for that tax year is 100%.

Example. Using the straight line method for property with a 5-year recovery period, the straight line rate is 20% (1 divided by 5) for the first tax year. After applying the half-year convention, the first year rate is 10% (20% divided by 2).

At the beginning of the second year, the remaining recovery period is 4½ years because of the half-year convention. The straight line rate for the second year is 22.2222% (1 divided by 4.5).

To figure your depreciation deduction for the second year:

1) Subtract the depreciation taken in the first year from the basis of the property, and
2) Multiply the remaining basis by the second year rate.

Residential rental and nonresidential real property. In the first year you claim depreciation for residential rental and nonresidential real property, you can only claim depreciation for the number of months the property is in use and you must use the mid-month convention (defined later). Also, for the first year of depreciation under the alternate MACRS method (described later), you must use the applicable convention to figure your depreciation deduction.

Conventions

In the year that you place property in service or in the year that you dispose of property, you are only allowed to claim depreciation for a part of the year. The part of the year (or convention) depends on the class of the property.

A half-year convention is used to figure the deduction for property other than nonresidential real and residential rental property. Under a special rule, a mid-quarter convention may have to be used (discussed later). For nonresidential real and residential rental property, use a mid-month convention in all situations.

Half-year convention. Under MACRS, the half-year convention treats all property placed in service, or disposed of, during a tax year as placed in service, or disposed of, in the middle of that tax year.

A half year of depreciation is allowable for the first year property is placed in service, regardless of when the property is placed in service during the tax year. For each of the remaining years of the recovery period, you will take a full year of depreciation. If you hold the property for the entire recovery period, a half year of depreciation is allowable for the year following the end of the recovery period. If you dispose of the property before the end of the recovery period, a half year of depreciation is allowable for the year of disposition.

Mid-quarter convention. Under a mid-quarter convention, all property placed in service, or disposed of, during any quarter of a tax year is treated as placed in service, or disposed of, in the middle of the quarter.

A mid-quarter convention must be used instead of a half-year convention if the following conditions occur in the last 3 months of a tax year.

1) You place in service depreciable property other than nonresidential real and residential rental property, *and*
2) The total basis of that property is more than 40% of the total bases of all such depreciable property you place in service during the year (whether or not all of the property is subject to MACRS).

For tax years beginning after March 31, 1988, you do not include in the total basis any property placed in service and disposed of during the same tax year. You can elect to have this provision apply to tax years beginning before April 1, 1988.

Example. During 1990, John Joyce purchases a dishwasher for $400, which he places in service in January; used furniture for $100, which he places in service in September; and a refrigerator for $500, which he places in service in October. John uses the calendar year as his tax year. The total bases of all property placed in service in 1990 is $1,000. The basis of the refrigerator is $500, and it was placed in service during the last 3 months of his tax year. Since the basis of $500 exceeds 40% of the total bases of all property ($1,000) placed in service during 1990, John must use the mid-quarter convention for all three items. The dishwasher, refrigerator, and used furniture are 7-year property under MACRS.

Mid-month convention. Under a mid-month convention all property placed in service, or disposed of, during any month is treated as placed in service, or disposed of, in the middle of that month.

Optional Tables

Optional depreciation tables can be used to compute annual depreciation under MACRS. The percentages in Tables A, B, and C make the change from declining balance to straight line in the year that straight line will yield a larger deduction. See *Depreciation methods*, earlier. If you do not choose to use the optional tables, see Publication 534, *Depreciation*, for information on how to figure depreciation.

How to use the tables. The following section explains how to use the optional table for both personal property and real property.

Personal property. For personal property, figure the depreciation deduction by multiplying your basis (explained earlier) in the property by a certain percentage. The percentages for the first 6 years are shown in the tables in this chapter for 5-, 7-, and 15-year property. The tables take the half-year and mid-quarter conventions into consideration in figuring percentages.

Use Table A for 5-year property, Table B for 7-year property, and Table C for 15-year property. Use the percentage in the first column (half-year convention) unless you must use the mid-quarter convention (explained earlier). If you must use the mid-quarter convention, use the column that corresponds to the calendar year quarter in which you place the property in service.

If you choose the straight line depreciation method, see Publication 534 for information on how to figure the depreciation.

Example 1. You purchased a stove and refrigerator and placed them in service on February 1, 1990. Your basis in the stove is $300 and your basis in the refrigerator is $500. You use the year 1 line of Table B, in the half-year convention column to compute the depreciation on the stove and refrigerator. Your 1990 depreciation deduction on the stove is $43 ($300 × .1429). Your 1990 depreciation deduction on the refrigerator is $71 ($500 × .1429).

Example 2. Assume the same facts in Example 1, except you buy the refrigerator in October 1990 instead of February. You cannot use the half-year convention column to figure depreciation on the stove and refrigerator. Your basis of the refrigerator ($500), placed in service in the last 3 months of the tax year, is more than 40% of the total bases of all property ($800) placed in service during 1990. Use the mid-quarter convention columns to figure your depreciation. Because the stove was placed in service in the first quarter of the year, you use the first quarter column of Table B to find the depreciation percentage on the year 1 line. Your 1990 depreciation deduction on the stove is $75 ($300 × .25). You use the fourth quarter column of Table B to find the depreciation percentage on the refrigerator since you placed it in service in the fourth quarter of 1990. Your depreciation deduction on the refrigerator is $18 ($500 × .0357).

Real property. Tables I and II, illustrated in this chapter, give the percentages for the first 6 years for real property placed in service after 1986. Table I covers residential rental property. Table II covers nonresidential real property. Choose the table for the class of property. Then find the column for the month that you placed the property in service. Use the percentages listed for that month for your depreciation deduction. The mid-month convention is considered in the percentages used in the tables.

Example. You purchased a single family rental house and placed it in service on February 1, 1990. Your basis in the house is $80,000. Use the percentage from the first line (year 1) of Table I, residential rental property, Column 2 (February), to compute your depreciation. Your 1990 depreciation deduction is $2,546 ($80,000 × .03182).

Additions or Improvements to Property

Figure the depreciation deduction for any additions or improvements to any property as if you placed the property in service at the same time the addition or improvement was made.

The MACRS class for the addition or improvement is determined by the MACRS class of the property to which the addition or improvement is made. Figure depreciation beginning on the date the addition or improvement is placed in service, or, if later, the date the property to which the addition or improvement was made is placed in service.

Example. You own a residential rental house that you are depreciating under ACRS. If you put an addition onto the house, and you place the improvement in service after 1986, you use MACRS for the addition. Under

MACRS the addition would be depreciated as residential rental property.

Alternate MACRS Method

If you choose, you can use an alternate MACRS method for most property. Under this method you use the straight line method of depreciation.

The following chart shows the recovery periods for property you depreciate under the alternate MACRS method.

Property	Recovery Period
Personal property with no class life	12 years
Nonresidential real and residential rental property	40 years
Section 1245 property that is real property with no class life	40 years
Automobiles and light duty trucks	5 years
Computers and peripheral equipment	5 years
Most other property	Class life

You can find the class life assigned to many properties in the *Table of Class Lives and Recovery Periods*, in Publication 534. If your property is not listed in the table, it is considered to have no class life.

Use the mid-month convention for nonresidential real and residential rental property. For all other property, use the half-year or mid-quarter convention.

Election. You make the election to use the alternate MACRS method by entering the depreciation on line 15 , Part 2 of Form 4562, *Depreciation and Amortization* .

The election of the alternate MACRS method for a class of property applies to all property in that class that is placed in service during the tax year of the election. However, the election applies on a property-by-property basis for nonresidential real and residential rental property.

Once you make the election to use the alternate MACRS method you cannot change your election.

Excluded Property

You cannot use MACRS for certain personal property placed in service before 1987 (before August 1, 1986, if election made) that is transferred after 1986 (after July 31, 1986, if election made). Generally, if you acquired the property from a related party, or if you or a related party used the property before 1987, you may not use MACRS. Property that does not come under MACRS must be depreciated under ACRS or one of the other methods of depreciation, such as straight line or declining balance. In addition, you may elect to exclude certain property from the application of MACRS. See Publication 534 for more information.

Other Rules About Depreciable Property

In addition to the rules about what methods you can use, there are other rules you should be aware of with respect to depreciable property.

If you dispose of depreciable property at a profit, you may have to report, as ordinary income, all or part of the profit. See Publication 544, *Sales and Other Dispositions of Assets.*

Table A — **MACRS 5-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	20.00%	35.00%	25.00%	15.00%	5.00%
2	32.00	26.00	30.00	34.00	38.00
3	19.20	15.60	18.00	20.40	22.80
4	11.52	11.01	11.37	12.24	13.68
5	11.52	11.01	11.37	11.30	10.94
6	5.76	1.38	4.26	7.06	9.58

Table B — **MACRS 7-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	14.29%	25.00%	17.85%	10.71%	3.57%
2	24.49	21.43	23.47	25.51	27.55
3	17.49	15.31	16.76	18.22	19.68
4	12.49	10.93	11.97	13.02	14.06
5	8.93	8.75	8.87	9.30	10.04
6	8.92	8.74	8.87	8.85	8.73

Table C — **MACRS 15-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	5.00%	8.75%	6.25%	3.75%	1.25%
2	9.50	9.13	9.38	9.63	9.88
3	8.55	8.21	8.44	8.66	8.89
4	7.70	7.39	7.59	7.80	8.00
5	6.93	6.65	6.83	7.02	7.20
6	6.23	5.99	6.15	6.31	6.48

Table I

Residential Rental Property (27.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.485%	3.182%	2.879%	2.576%	2.273%	1.970%	1.667%	1.364%	1.061%	0.758%	0.455%	0.152%
2	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
3	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
4	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
5	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
6	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636

Table II

Nonresidential Real Property (31.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.042%	2.778%	2.513%	2.249%	1.984%	1.720%	1.455%	1.190%	0.926%	0.661%	0.397%	0.132%
2	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
3	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
4	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
5	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
6	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175

Additional tax on preference items. If you use accelerated depreciation, you may have to file Form 6251, *Alternative Minimum Tax—Individuals.* Accelerated depreciation includes MACRS and ACRS and any other method that allows you to deduct more depreciation than you could deduct using a straight line method. For more information, see Publication 909, *Alternative Minimum Tax for Individuals.*

Limits on Rental Losses

Generally, you cannot deduct losses from rental real estate activities unless you have income from other passive activities. See *Passive Activity Limits*, discussed later.

At-risk rules limit the amount of deductible losses from holding most real property placed in service after 1986.

Losses from passive activities are first subject to the at-risk rules.

Exception. If your rental losses are less than $25,000 ($12,500 if married filing separately), the passive activity limits probably do not apply to you. See *Losses From Rental Real Estate Activities*, later.

At-Risk Rules

The at-risk rules place a limit on the amount you can deduct as losses from activities often described as tax shelters. Holding real property (other than mineral property) was not subject to the at-risk rules before 1987.

Generally, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount a taxpayer has at risk in the activity at the end of the tax year. A taxpayer is considered at risk in an activity to the extent of cash and the adjusted basis of other property the taxpayer contributed to the activity and certain amounts borrowed for use in the activity. See Publication 925, *Passive Activity and At-Risk Rules*, for more information.

Passive Activity Limits

You generally cannot offset income, other than passive income, with losses from passive activities. Nor can you offset taxes on income, other than passive income, with credits resulting from passive activities.

Any rental activity is a passive activity. For this purpose, a rental activity generally is an activity, the income from which consists of payments principally for the use of tangible property, rather than for the performance of substantial services.

Form 8582, *Passive Activity Loss Limitations*, is used to figure the amount of any passive activity loss for the current tax year for all activities and the amount of the passive activity loss allowed on your tax return.

Losses From Rental Real Estate Activities

You are allowed to deduct up to $25,000 ($12,500 if married filing separately and living apart from your spouse the entire year) of losses from rental real estate activities in which you ***actively participated*** during the tax year. The offset allows you to deduct up to $25,000 of otherwise unallowable losses from rental real estate activities from other income (nonpassive income). The $25,000 ($12,500) figure is reduced if your adjusted gross income is more than $100,000.

Active participation. You actively participate in a rental real estate activity if you own at least 10% of the rental property. For these purposes, you are considered to own any portion of the property owned by your spouse.

Additional information on the passive loss limits, including information on the treatment of unused disallowed passive losses and credits and the treatment of gains and losses realized on the disposition of a passive activity, is provided in Publication 925.

Property used as a home. When figuring your passive activity losses, do not treat any income, deductions, gain, or loss related to the rental of property as items related to a passive activity if you used the property as your home (that is, you used it for personal purposes for more than 14 days and more than 10% of the number of days for which it was rented at a fair rental price).

How To Report Your Rental Income and Expenses

Report rental income on your return for the year you actually or constructively receive it. You are considered to constructively receive income when it is made available to you, for example, by being credited to your bank account.

For more information about when you constructively receive income, see *Accounting Methods* in Chapter 1.

Expenses carried over. If you could not deduct all of your 1989 rental expenses because you used your property as a home, treat the part you could not deduct in 1989 as a 1990 rental expense. Deduct the expenses carried over to a year only up to the amount of your gross rental income for that year, even if you did not use the property as your home for that year.

Where to report. Where you report rental income and expenses, including depreciation, depends on whether you provide certain services to your tenant.

If you rent out buildings, rooms, or apartments, and provide only heat and light, trash collection, etc., you normally report your rental income and expenses in Part I of Schedule E (Form 1040), *Supplemental Income and Loss*. However, see *Not Rented For Profit*, earlier.

If you provide additional services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on **Schedule C** (Form 1040), *Profit or Loss from Business*. For information on Schedule C, see Publication 334, *Tax Guide for Small Business*. You also may have to pay self-employment tax on your rental income. See Publication 533, *Self-Employment Tax*.

Schedule E

Use Part I of Schedule E (Form 1040) to report your rental income and expenses. List your total income, expenses, and depreciation for each rental property. Be sure to answer the question on line 2. On line 20 of Schedule E (Form 1040), show the depreciation you are claiming.

You must complete and attach Form 4562, *Depreciation and Amortization*, if:

- You are claiming depreciation on rental property placed in service during 1990, or
- You are claiming depreciation on any rental property that is listed property (such as a car), regardless of when it was placed in service, or
- You are claiming a section 179 expense deduction or amortization of costs that begins in 1990.

If you have more than three rental properties, use as many Schedules E as are needed to list the properties. Complete lines 1 and 2 for each property. However, fill in the "Totals" column for lines 3, 4, 11, 19, 20, and 24 through 26 on only one Schedule E. The figures in the total column on that Schedule E should be the combined totals of all the schedules. If you need to use page 2 of Schedule E, use page 2 of the Schedule E on which you entered the combined totals.

Example. Eileen Green owns a townhouse that she rents out. She receives $1,100 a month rental income. Her rental expenses for the year are as follows:

Fire insurance (1-year policy)	$ 200
Mortgage interest	5,000
Fee paid to real estate company for collecting monthly rent	572
General repairs	175
Real estate taxes imposed and paid in 1990	800

Eileen bought the property and placed it in service on January 1, 1990. Her basis for depreciation of the townhouse is $65,000. She is using MACRS with a 27.5-year recovery period. On April 1, 1990, Eileen bought a new dishwasher for the rental property at a cost of $425. She uses MACRS with a 7-year recovery period. She uses Form 4562 to figure and report her MACRS deduction.

Eileen figures her net rental income or loss for the townhouse as follows:

Total rental income received ($1,100 × 12)		$13,200
Minus Expenses:		
Fire insurance	$ 200	
Mortgage interest	5,000	
Real estate fee	572	
General repairs	175	
Real estate taxes	800	
Total expenses		6,747
Balance		$ 6,453
Minus Depreciation:		
On townhouse ($65,000 × 3.485%)	$2,265	
On dishwasher ($425 × 14.29%)	61	
Total depreciation		2,326
Net rental income for townhouse		$ 4,127

Form 1098. If you paid $600 or more of mortgage interest on your rental property, you should receive a Form 1098, *Mortgage Interest Statement*, or a similar statement showing the interest you paid for the year. If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid interest on, the mortgage, and the other person received the Form 1098, report the interest on line 12 of Schedule E. Attach a statement to your return showing the name and address of the other person. In the left margin of Schedule E, next to line 12, write "see attached."

11. Retirement Plans, Pensions, and Annuities

This chapter explains the tax treatment of amounts you receive from employee pensions or annuities and disability pensions or annuities.

Information on amounts you receive from an Individual Retirement Arrangement (IRA), as well as general information on IRAs, is in Chapter 19.

Employee Pensions or Annuities

Generally, if you did not pay any part of the cost of your employee pension or annuity, and your employer did not withhold part of the cost of the contract from your pay while you worked, the amounts you receive each year are fully taxable. You must report them on your income tax return.

If you pay part of the cost of your annuity, you are not taxed on the part of the annuity you receive that represents a return of your cost. The rest of the amount you receive is taxable. You use either the *General Rule* or the *Simplified General Rule* to figure the taxable and nontaxable parts of your pension or annuity.

If your annuity starting date was before July 2, 1986, and you received a total equal to or more than your cost within the first 3 years after you first received your annuity, you should have been reporting your payments under the *Three-Year Rule*. Under this rule, you excluded all the annuity payments from income until you received a total equal to your cost. After that, all your payments are fully taxable. 1989 was the last year that amounts could be excluded using the Three-Year Rule.

Railroad retirement benefits. Part of the railroad retirement benefits you receive is treated like social security benefits, and part is treated like an employee pension. For information about railroad retirement benefits treated as an employee pension, see *Railroad Retirement* in Publication 575, *Pension and Annuity Income (Including Simplified General Rule)*.

Credit for the elderly or the disabled. If you receive a pension or annuity, you may be able to take this credit. See Chapter 34 for information about this credit.

Withholding and estimated tax. The payer of your pension, profit-sharing, stock bonus, annuity, or deferred compensation will withhold income tax on the taxable parts of amounts paid to you. You can tell the payer how to withhold by filing Form W-4P, *Withholding Certificate for Pension or Annuity Payments*. You can choose not to have tax withheld. You also make this choice on Form W-4P. If you choose not to have tax withheld, you may have to pay estimated tax.

For more information, see *Withholding on Pensions and Annuities* and *Estimated Tax* in Chapter 5.

Loans. If you borrow money from an employer's qualified pension or annuity plan, a tax-sheltered annuity program, a government plan, or from a contract purchased under any of these plans, you may have to treat the loan as a distribution. This means that you may have to include in income all or part of the amount borrowed. Even if you do not have to treat the loan as a distribution, you might not be able to deduct the interest on the loan in some situations. For details, see *Loans Treated as Distributions* in Publication 575. For information on the deductibility of interest, see Chapter 24.

Elective deferrals. Some retirement plans allow you to choose (elect) to have part of your pay contributed by your employer to a retirement fund, rather than have it paid to you. Tax on this money is deferred until it is distributed to you.

Elective deferrals generally include elective contributions to cash or deferred arrangements (known as *section 401(k) plans*), section 501(c)(18) plans, salary reduction simplified employee pension (SEP) plans, and tax-sheltered annuities provided for employees of tax-exempt organizations and public schools.

For information on the tax treatment of elective deferrals, including their limits, see *Elective deferrals* under *Fully Taxable Payments* in Publication 575.

Deferred compensation plans of state and local governments and tax-exempt organizations. If you participate in one of these plans (known as *section 457 plans*), you will not be taxed currently on your pay that is deferred under the plan. You or your beneficiary will be taxed on this deferred pay only when it is distributed or otherwise made available to either of you.

Distributions of deferred pay are not eligible for 5- or 10-year averaging or rollover treatment, or the death benefit exclusion. Distributions are, however, subject to the *Tax for Failure to Make Minimum Distribution*, discussed later.

For information on these deferred compensation plans and their limits, see *Deferred compensation plans of state and local governments and tax-exempt organizations (section 457 plans)* under *Fully Taxable Payments* in Publication 575.

Cost

Before you can figure how much, if any, of your pension or annuity benefits is taxable, you must first determine your cost in the plan (your investment). Your total cost in the plan includes everything that you paid. It also includes amounts your employer paid that you were required to include in your income at the time paid. From this total cost paid or considered paid by you, subtract any refunds of premiums, rebates, dividends, unrepaid loans, or other tax-free amounts you received before the later of the annuity starting date or the date on which you received your first payment. If you use the General Rule to figure the tax treatment of your annuity payments, you must also subtract from your cost the value of any refund feature in your contract.

The *annuity starting date* is the later of the first day of the first period that you receive a payment from the plan or the date on which the plan's obligation became fixed.

Your employer or the organization that pays you the benefits (plan administrator) should be able to tell you what your cost is in the plan.

Foreign employment. If you worked before 1963 in a foreign country and your employer paid into your retirement plan, a part of those payments may be considered part of your cost. For details, see *Foreign employment* in Publication 575.

General Rule

You must use the General Rule to figure the taxability of your pension or annuity if your annuity starting date is after July 1, 1986, and you do not qualify for, and choose, the Simplified General Rule (explained below). You should also be using the General Rule if your annuity starting date was before July 2, 1986, and you did not qualify to use the Three-Year Rule.

Under the General Rule, a part of each payment is nontaxable because it is considered a return of your cost. The remainder of each payment (including the full amount of any later cost-of-living increases) is taxable. Finding the nontaxable part is very complex and requires you to use actuarial tables. For a full explanation and the tables you need, get Publication 939, *Pension General Rule (Nonsimplified Method)*.

The nontaxable amount remains the same even if the total payment increases. If your annuity starting date was before 1987, you continue to exclude the same nontaxable amount from each annuity payment even if you outlive the life expectancy used to figure your expected return. If your annuity starting date is after 1986, your total exclusion over the years cannot be more than your cost of the contract reduced by the value of any refund feature.

If your annuity starting date is after July 1, 1986, and you (or a survivor annuitant) die before the cost is recovered, an itemized deduction is allowed for the unrecovered cost on your, or your survivor's, final income tax return. The deduction is not subject to the 2% floor on certain miscellaneous itemized deductions.

Simplified General Rule

If you qualify to use the Simplified General Rule, you will probably find it both simpler and more beneficial than the General Rule explained earlier in figuring the taxable and nontaxable parts of your annuity.

Who can use it. You may be able to use the Simplified General Rule if you are a retired employee or if you are receiving a survivor annuity as the survivor of a deceased employee. You can use it to figure the taxability of your pension *only* if:

- Your annuity starting date is after July 1, 1986,
- The annuity payments are for either (a) your life, or (b) your life and that of your beneficiary,
- The annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity, and
- At the time the payments began, either you were under age 75 or the payments were guaranteed for fewer than 5 years.

Amount of exclusion. If your annuity starting date is after July 1, 1986, and before January 1, 1987, you continue to take your monthly exclusion (figured on line 4 of the worksheet) for as long as you receive your annuity.

If your annuity starting date is after 1986, the total amount of annuity you can exclude over the years is limited to your cost.

In both cases, any unrecovered cost at your or last annuitant's death where no further payments are to be made as an annuity is allowed as an itemized deduction in the last tax year. This deduction is not subject to the 2% floor on miscellaneous itemized deductions. The deduction is taken on the final return of the decedent. If the annuity contract provides for payment to a beneficiary or the estate of the decedent, the deduction for any unrecovered cost is allowed to the person who received the payment.

How to use it. If you meet these conditions and you choose the Simplified General Rule, use the following worksheet to figure your taxable pension. In completing this worksheet, use your age at the birthday preceding your annuity starting date. Be sure to keep a copy of the completed worksheet; it will help you figure your 1991 taxable pension.

Worksheet for Simplified General Rule

1.	Total pension received this year. Also enter this amount on Form 1040, line 17a, or Form 1040A, line 11a	$
2.	Your cost in the plan (contract) at annuity starting date, plus any death benefit exclusion*	
3.	Age at annuity starting date: / Enter:	
	55 and under — 300	
	56 – 60 — 260	
	61 – 65 — 240	
	66 – 70 — 170	
	71 and over — 120	
4.	Divide the amount on line 2 by the number on line 3	
5.	Multiply the amount on line 4 by the number of months for which this year's payments were made	
	NOTE: If your annuity starting date is **before 1987**, subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.	
6.	Any amounts previously recovered tax free in years after 1986	
7.	Subtract the amount on line 6 from the amount on line 2	
8.	Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.)	
9.	**Taxable pension for year.** Subtract the amount on line 8 from the amount on line 1. Also enter the amount on Form 1040, line 17b, or Form 1040A, line 11b	$
10.	Add the amounts on lines 6 and 8	
11.	Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2	$

NOTE: If your Form W-2P shows a larger taxable amount, use the amount on line 9 instead of the amount from Form W-2P.

*Statement for death benefit exclusion

Cost in plan (contract) ..... $

Death benefit exclusion .....

Total (enter on line 2 above) ..... $

Signed: _____

Date: _____

KEEP FOR YOUR RECORDS

The following example illustrates the simplified method:

Example. Bill Kirkland, age 65, began receiving retirement benefits under a joint and survivor annuity to be paid for the joint lives of Bill and his wife, Kathy. His annuity starting date was January 1, 1990. He had contributed $24,000 to the plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,000 a month, and Kathy is to receive a monthly survivor benefit of $500 upon Bill's death.

Bill chooses to use the Simplified General Rule computation. He fills in the worksheet as follows:

Worksheet for Simplified General Rule

1.	Total pension received this year. Also enter this amount on Form 1040, line 17a, or Form 1040A, line 11a	$12,000
2.	Your cost in the plan (contract) at annuity starting date, plus any death benefit exclusion*	24,000
3.	Age at annuity starting date: / Enter:	
	55 and under — 300	
	56 – 60 — 260	
	61 – 65 — 240	
	66 – 70 — 170	
	71 and over — 120	240
4.	Divide the amount on line 2 by the number on line 3	100
5.	Multiply the amount on line 4 by the number of months for which this year's payments were made	1,200
	NOTE: If your annuity starting date is **before 1987**, subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.	
6.	Any amounts previously recovered tax free in years after 1986	0
7.	Subtract the amount on line 6 from the amount on line 2	24,000
8.	Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.)	1,200
9.	**Taxable pension for year.** Subtract the amount on line 8 from the amount on line 1. Also enter this amount on Form 1040, line 17b, or Form 1040A, line 11b	$10,800
10.	Add the amounts on lines 6 and 8	1,200
11.	Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2	$22,800

NOTE: If your Form W-2P shows a larger taxable amount, use the amount on line 9 instead of the amount from Form W-2P.

*Statement for death benefit exclusion

Cost in plan (contract) ..... $

Death benefit exclusion .....

Total (enter on line 2 above) ..... $

Signed: _____

Date: _____

KEEP FOR YOUR RECORDS

Bill's tax-free monthly amount is $100 (see line 4 of the worksheet). If Bill lives to collect more than 240 monthly payments, Bill will have to include in his gross income the full amount of any annuity payments received after 240 payments have been made.

If Bill does not live to collect 240 monthly payments and Bill's wife, Kathy, begins to receive monthly payments, she will also exclude $100 from each monthly payment until 240 payments (Bill's and hers) have been collected. If she dies before 240 payments have been made, a miscellaneous itemized deduction (not subject to the 2% floor on miscellaneous deductions) will be allowed for the unrecovered cost on Kathy's final income tax return.

Death benefit exclusion. If you are a beneficiary of a deceased employee or former employee, you may qualify for a death benefit exclusion of up to $5,000, discussed later in this chapter. If you choose the Simplified General Rule and you qualify for the death benefit exclusion, you increase your cost in the pension or annuity plan (on line 2 of the worksheet) by the amount of the allowable death benefit exclusion.

However, the payer of the annuity cannot add the death benefit exclusion to the cost for reporting the nontaxable and taxable parts of a payment on Form W-2P. Thus, there will be a difference in the amounts you will figure for yourself and the amounts the payer will figure. You must attach a signed statement to your income tax return stating that you are entitled to the death benefit exclusion in making the Simplified General Rule computation. Or, you may use the statement shown at the bottom of the worksheet. This statement is required every year until the cost in the pension or annuity plan is fully recovered.

Example. Diane Greene, age 48, began receiving a $1,500 monthly annuity in 1990 upon the death of her husband. He died before becoming entitled to an annuity. She received 10 payments in 1990. Her husband had contributed $25,000 to his qualified employee plan. In addition, Diane finds that she is entitled to a $5,000 death benefit exclusion for the annuity payments. She adds that amount to her husband's contributions to the plan, making her total cost in the plan $30,000.

Diane chooses to use the Simplified General Rule. She fills out the worksheet as follows:

Worksheet for Simplified General Rule

1.	Total pension received this year. Also enter this amount on Form 1040, line 17a, or Form 1040A, line 11a	$15,000
2.	Your cost in the plan (contract) at annuity starting date, plus any death benefit exclusion*	30,000
3.	Age at annuity starting date: / Enter:	
	55 and under — 300	
	56 – 60 — 260	
	61 – 65 — 240	
	66 – 70 — 170	
	71 and over — 120	300
4.	Divide the amount on line 2 by the number on line 3	100
5.	Multiply the amount on line 4 by the number of months for which this year's payments were made	1,000
	NOTE: If your annuity starting date is **before 1987**, subtract line 5 from line 1 and enter the result (but not less than zero) on line 9 below. Skip lines 6, 7, 8, 10, and 11.	

6. Any amounts previously recovered tax free in years after 1986	0
7. Subtract the amount on line 6 from the amount on line 2	30,000
8. Enter the lesser of the amount on line 5 or the amount on line 7, but no more than the amount on line 1. (If this is zero, your pension is fully taxable.)	1,000
9. Taxable pension for year. Subtract the amount on line 8 from the amount on line 1. Also enter this amount on Form 1040, line 17b, or Form 1040A, line 11b	$14,000
10. Add the amounts on lines 6 and 8	1,000
11. Balance of cost to be recovered. Subtract the amount on line 10 from the amount on line 2	$29,000

NOTE: If your Form W-2P shows a larger taxable amount, use the amount on line 9 instead of the amount from Form W-2P.

*Statement for death benefit exclusion

Cost in plan (contract)	$25,000
Death benefit exclusion	5,000
Total (enter on line 2 above)	$30,000

Signed: Diane Grease

Date: 4/12/91

KEEP FOR YOUR RECORDS

In completing Form W–2P, the payer of the annuity (Diane's husband's employer) chooses to report the taxable part of the annuity payments using the Simplified General Rule. However, since the payer does not adjust the investment in the contract by the death benefit exclusion, the payer figures the tax-free part of each monthly payment to be $83.33, as follows:

Total investment: $25,000 / Expected payments: 300 = $83.33 (Monthly return of investment)

However, Diane had figured a $100 monthly tax-free amount (see line 4 of the worksheet). Because of this difference in the computations, the Form W–2P given by the payer to Diane will show a greater taxable amount than what she figured for herself. She should report on line 17b of Form 1040 only the smaller taxable amount based on her own computation. She completes and signs the statement at the bottom of the worksheet and attaches it to her income tax return to show that she is entitled to the death benefit exclusion in making the Simplified General Rule computation.

Changing the method. If your annuity starting date is after July 1, 1986, you can change the way you figure your pension cost recovery exclusion (from the General Rule to the Simplified General Rule, or the other way around) by filing amended returns for all your tax years beginning with the year in which you received your first annuity payment. Generally, you can make the change only within 3 years from the due date of your return ***for the year in which you received your first annuity payment*** (or, if later, within 2 years from the date the tax for that year was paid). You must use the same method for all years, unless you choose the Simplified General Rule for 1988 and later years but not for 1986 or 1987 (see the following discussion).

Annuity starting date before 1988. If your annuity starting date was before July 2, 1986, you cannot choose the Simplified General Rule at any time. If your annuity starting date is after July 1, 1986, and before January 1, 1988, you can:

1) Start to use the Simplified General Rule in 1988 without amending your 1986 or 1987 returns, or
2) Amend your 1987 return (and, if the time period has not expired, your 1986 return) to apply the Simplified General Rule to the annuity distributions for that year (or years).

If you choose to use the Simplified General Rule beginning in 1988 without amending your prior returns, figure your taxable and nontaxable annuity amounts using your age as of the actual annuity starting date in 1986 or 1987.

If you received your first annuity payment in 1987, and you choose to apply the Simplified General Rule to your 1987 distributions, file an amended return for 1987. If you received your first annuity payment in 1986, and the time period for filing an amended return for that year has not yet expired, you can choose to apply the Simplified General Rule to your 1986 and 1987 distributions. You do this by filing amended returns for both 1986 and 1987. You cannot choose the Simplified General Rule for 1987 only, while applying the General Rule to 1986; you must apply the Simplified General Rule to all years beginning with the year in which you received your first annuity payment if you choose to apply it to any of those years. See *Changing the method*, above.

How to Report

If you file Form 1040, report your total annuity on line 17a and the taxable part on line 17b. If your pension or annuity is fully taxable, enter it on line 17b; no entry is needed on line 17a.

If you file Form 1040A, report your total annuity on line 11a, and the taxable part on line 11b. If your pension or annuity is fully taxable, enter it on line 11b; no entry is needed on line 11a.

If you receive more than one annuity and at least one of them is not fully taxable, enter the total amount received from ***all*** annuities on line 17a, Form 1040, or line 11a, Form 1040A, and enter the taxable part on line 17b, Form 1040, or line 11b, Form 1040A. If all the annuities you receive are fully taxable, enter the total of all of them on line 17b, Form 1040, or line 11b, Form 1040A.

If you receive benefits from more than one program, such as a pension plan and a profit-sharing plan, you must account for each separately even though the benefits from both may be included in the same check. For example, benefits from one of your programs could be fully taxable, while the benefits from your other program could be taxable under the General Rule or Simplified General Rule. Your former employer or the plan administrator should be able to tell you if you have more than one program.

If you file a joint return and you and your spouse each receive one or more pensions or annuities, report the total of the pensions and annuities on line 17a, Form 1040, or line 11a, Form 1040A, and report the taxable part on line 17b, Form 1040, or line 11b, Form 1040A.

Survivors. If you, as the survivor of a retiree who had reported an annuity under the Three-Year Rule, receive a survivor annuity, you include your annuity payments in income after the total received by the retiree and you equals the retiree's cost.

If the retiree was reporting the annuity payments under the General Rule, you should apply to your initial payment called for in the contract the same exclusion percentage as the retiree used. The resulting dollar exclusion will then remain fixed for as long as you receive your survivor annuity. Increases in the survivor annuity made after the original retiree's annuity starting date are fully taxable.

If the retiree had chosen to report the annuity under the Simplified General Rule, the monthly exclusion (arrived at on line 4 of the worksheet shown earlier) remains fixed. You continue to claim this exclusion each month.

If the annuity starting date is after 1986, the total exclusion over the years cannot be more than the cost minus (if the General Rule is used) the value of any refund feature.

If you are a survivor of an individual who died while still employed, you may qualify to add up to $5,000 to the decedent's cost to be recovered tax free. This ***death benefit exclusion,*** which is discussed later, is treated as an addition to the cost of the annuity.

Estate tax. If the annuity was a joint and survivor annuity and was included in the decedent's estate, an estate tax may have been paid on it. As the surviving annuitant, you can deduct, as an itemized deduction, the part of the total estate tax that was paid because of the annuity. This deduction is not subject to the 2% floor on certain miscellaneous itemized deductions. The deceased annuitant must have died after the annuity starting date. This amount cannot be deducted in one year. It must be deducted equally over your remaining life expectancy. See *Estate Tax Deduction* in Publication 559, *Tax Information for Survivors, Executors, and Administrators,* for information on the deduction.

Death Benefit Exclusion

If you are the beneficiary of a deceased employee or former employee, the pension or annuity you get because of that person's death may qualify for a death benefit exclusion.

This exclusion is limited to $5,000. It generally applies to the amount by which the present value of the survivor annuity, figured as of the date of the employee's death, exceeds the larger of: (1) the employee's total regular contributions to the plan; or (2) the amount the employee had a nonforfeitable right (a right that cannot be taken away) to receive just before death.

If you are eligible for the exclusion, add it to the cost or unrecovered cost of the annuity when you figure your cost at the annuity starting date.

If you are the survivor under a joint and survivor annuity, the exclusion applies only if either:

1) The decedent died before receiving, or becoming entitled to receive, retirement pension or annuity payments, or
2) The decedent received disability income payments that were not treated as pension or annuity income.

For more information on the death benefit exclusion, see *Payments to beneficiaries of deceased employees* under *Life Insurance Proceeds* in Chapter 13, and *Death benefit exclusion* under *Investment in the Contract (Cost)* in Publication 575.

Lump-Sum Distributions

Lump-sum distributions you receive from a qualified retirement plan (an employer's pension, stock bonus, or profit-sharing plan) may be given special tax treatment. For information on a distribution you receive that includes employer securities, see *Distributions of employer securities* in Publication 575.

A lump-sum distribution is the distribution within a single tax year of an employee's entire balance, excluding certain amounts forfeited or subject to forfeiture, from all of the employer's qualified pension plans, all of the employer's qualified stock bonus plans, or all of the employer's qualified profit-sharing plans. The distribution must be paid:

1) Because of the employee's death,
2) After the employee reaches age 59½,
3) Because the employee separates from service, or
4) After a self-employed individual becomes totally and permanently disabled.

The separation-from-service condition in (3) does not apply to a self-employed individual.

A distribution you receive based on your ***voluntary deductible employee contributions (DECs)*** does not qualify as a lump-sum distribution.

Tax treatment. You can recover your ***cost*** in the lump sum tax-free. Also, you may be entitled to special tax treatment for the remaining part of the distribution.

In general, your ***cost*** consists of:

1) Your total nondeductible contributions to the plan,
2) The total of your taxable one-year term costs of life insurance,
3) Any employer contributions that were taxable to you, and
4) Repayments of loans that were taxable to you.

You must reduce this cost by amounts previously distributed to you tax free.

Long-term capital gain treatment. If the employee for whom the lump-sum distribution is paid reached age 50 before 1986 (was born before 1936), you can choose to treat a portion of the taxable part of a lump-sum distribution as a long-term capital gain taxable at a 20% (.20) rate. This treatment applies to the portion you receive for the employee's participation in the plan before 1974. A recipient can make only one choice with regard to an employee. Use Form 4972, *Tax on Lump-Sum Distributions*, to make this choice.

Regardless of the employee's age, you can report part of the capital gain on Schedule D (Form 1040), if you do not make the choice in the preceding paragraph. The part that is eligible for Schedule D treatment is being phased out between 1988 and 1991, and the treatment will be unavailable after 1991. (50% of the capital gain is eligible for this capital gain treatment for 1990.) Also, the 20% rate for the choice in the preceding paragraph does not apply.

Special averaging method. If the employee for whom the lump-sum distribution is paid reached age 50 before 1986 (was born before 1936), you can elect special averaging of the ordinary income portion of the distribution. (This also includes the capital gain portion of the distribution if you do not choose capital gain treatment for it.) To qualify, you must elect to use special averaging on all lump-sum distributions received in the tax year.

To use special averaging for a distribution you receive for your own participation in the retirement plan, you must have been a participant in the plan for at least 5 years. You can only make one lifetime election to use this method for any employee.

If you choose the special averaging method, you generally figure your tax, using Form 4972, as though the distribution were received over 5 years.

However, you can treat the distribution as though it were received over 10 years instead of 5 years, provided you apply the 1986 tax rates to it. Form 4972 shows how to make this computation. The Form 4972 Instructions contain a special 1986 tax rate schedule that you must use in making the 10-year averaging computation.

Form 1099–R. If you receive a total distribution from a plan, you should receive a Form 1099–R, *Statement for Recipients of Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.* The Form 1099–R shows if a distribution qualifies as a lump-sum distribution. If the distribution qualifies, box 3 shows the capital gain, and box 2 minus box 3 is the ordinary income. If you do not get a Form 1099–R, or if you have questions about it, contact your plan administrator.

Rollovers. Generally, a rollover is a tax-free transfer of cash or other assets from a qualified retirement plan to an ***eligible retirement plan*** (defined below).

If you receive 50% or more of the balance to your credit in your employer's qualified plan, you may qualify to roll over the otherwise taxable part of this distribution to another retirement program. You do not pay tax on the amount that is rolled over. The amount you roll over, however, is generally taxable later when it is paid to you or your survivor.

You must complete the rollover by the 60th day following the day on which you receive the distribution. (This 60-day period is extended for any time the amount distributed is in a frozen deposit in a financial institution.) For all rollovers to an Individual Retirement Arrangement (IRA), you must irrevocably elect rollover treatment by written notice to the trustee or issuer of the IRA.

In general, the most you can roll over is the part that would be taxable if you did not roll it over. From a total distribution, the most you can roll over is the fair market value of all the property you receive, minus any employee contributions you made to the plan (other than accumulated deductible employee contributions).

An eligible retirement plan is an IRA, a qualified employee retirement plan, or a qualified annuity plan. Partial distributions (less than the entire balance to your credit in the plan) may be rolled over only to an IRA. However, a later distribution to you from an IRA will not qualify for the capital gain or special averaging treatment discussed earlier.

More information. Since the rules on rollovers are complex, see *Rollovers* in Publication 575 for details.

Deductible voluntary employee contributions. If you receive a distribution from your employer's qualified plan of part of the balance of your accumulated deductible voluntary contributions, you can roll over tax free any part of this distribution. The rollover can be either to an IRA or to certain other qualified plans.

Distributions you get as the beneficiary of a deceased employee may be accrued salary payments, distributions from employee profit-sharing, pension, annuity, and stock bonus plans, or other items that should be treated separately for tax purposes. How you treat these distributions depends on what is included in them.

Salaries or wages paid after the death of the employee are usually taxable income to you, the beneficiary.

If the employee died while still employed, and the employee made contributions to a profit-sharing, pension, annuity, or stock bonus plan, you, as the beneficiary, use the General Rule or the Simplified General Rule (discussed earlier) to figure the taxable amount. The deceased employee's contributions to the plan and the death benefit exclusion, if applicable, are usually your cost.

A surviving spouse who, as the beneficiary, receives a lump-sum distribution from a qualified profit-sharing, pension, annuity, or stock bonus plan may qualify to make a tax-free rollover of all or part of the taxable portion of the distribution to an IRA. However, a later distribution to the spouse from an IRA will not qualify for the capital gain or special averaging treatment discussed earlier. See *Rollovers* in Publications 575 and 590 for more information.

Under certain conditions, you also may be eligible for an employee's death benefit exclusion of up to $5,000. See *Death Benefit Exclusion*, earlier.

Employee's life insurance proceeds paid in a lump sum under an insurance contract on the death of an employee usually are not taxable. However, any amounts you received that are larger than the face amount of the life insurance are taxable to the extent of the excess. Life insurance proceeds are discussed in Chapter 13.

Bond Purchase Plans

The Department of the Treasury stopped issuing U.S. Retirement Plan Bonds after April 30, 1982. They were a special series of interest-bearing bonds that retirement plans could buy.

If your plan bought retirement bonds, you can cash them at any time. A beneficiary can cash them after the participant's death. Interest on the bonds stops 5 years after the owner of the bonds dies. They may be cashed at any Federal Reserve Bank branch or at the office of the Treasurer of the United States.

If a retirement bond is distributed from a bond purchase plan to you as an employee or beneficiary and you cash in the bond, you are taxed on the amount received minus your cost (normally, any voluntary nondeductible employee payments used to buy that bond). However, you can defer the tax on the amount received by rolling it over to an IRA as discussed under *Rollovers* in Chapter 19. You can also roll it over to a qualified employer plan (but later distributions of the rollover amount do not qualify for 5– or 10–year averaging or capital gain treatment covered earlier).

Tax on Early Distributions

Distributions you receive from your ***qualified retirement plan*** before you reach age 59½ are usually subject to an additional tax of 10% on the taxable part of the distribution.

For this purpose, a ***qualified retirement plan*** means:

1) A qualified employee retirement plan,
2) A qualified annuity plan,
3) A tax-sheltered annuity plan for employees of public schools or tax-exempt organizations, or
4) An Individual Retirement Arrangement (IRA).

Exceptions to tax. The additional tax does not apply to distributions that are:

1) Made to a beneficiary or to the estate of the participant on or after his or her death,
2) Made because you, the participant, are totally and permanently disabled,
3) Made as part of a series of substantially equal periodic (at least annual) payments over your life expectancy or the joint life expectancy of you and your beneficiary,
4) Made to you on separating from service in or after the year in which you reach age 55,
5) Made to you, to the extent you have deductible expenses for medical care (whether or not you itemize deductions for the tax year),
6) Made to alternate payees under qualified domestic relations orders, or
7) Made to you if, as of March 1, 1986, you separated from service and began receiving benefits from the qualified plan under a written election designating a specific schedule of benefit payments.

The exception in (3) applies to distributions from non-IRA plans ***only*** if the payments begin after you separate from service. The exceptions in (4), (5), and (6) do not apply to IRA distributions.

Form 5329. Use Form 5329, *Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts*, to report the additional tax you owe on the taxable part of the early distribution. You must also file Form 5329 if you meet one of the exceptions listed earlier, but only if the exception is ***not*** shown on the Form 1099 or Form W-2P that you received for the distribution.

Tax on Excess Distributions

If ***retirement distributions*** in excess of $150,000 are made to you during the calendar year, you are subject to a 15% excise tax on the excess. The tax is offset by any 10% early withdrawal tax that applies to the excess distribution (see the preceding discussion).

Retirement distributions, for this purpose, include distributions during the taxable year from qualified employee retirement plans, qualified annuity plans, tax-sheltered annuities, and Individual Retirement Arrangements (IRAs).

Excluded distributions. The following distributions are excluded from the tax:

- Distributions after death,
- Taxable distributions to an alternate payee under a qualified domestic relations order that are includible in the income of the alternate payee,
- Distributions attributable to the employee's investment in the contract,
- Distributions to the extent rolled over tax free,
- Retirement distributions of annuity contracts, the value of which are not included in gross income at the time of the distribution (other than distributions under, or proceeds from the sale or exchange of, such contracts),
- Retirement distributions of excess deferrals (and income allocable to them), and
- Retirement distributions of excess contributions (and income allocable to them) under section 401(k) plans or IRAs, or excess aggregate contributions (and income on them) under qualified plans. The aggregate contributions relate to highly compensated employees and the plan will figure the excess.

For more information, see *Excluded distributions* under *Tax on Excess Distributions* in Publication 575.

Combining distributions. If distributions for you are made to you and others, the distributions must be combined in figuring the amount of excess distributions for the year.

Lump-sum distributions. A different limit applies if you elect lump-sum distribution treatment (special averaging or capital gain treatment). In this case, the $150,000 annual amount is increased 5 times to $750,000. Then, this increased amount of $750,000 is applied separately to the lump-sum distribution for purposes of figuring the separate tax on the lump-sum distribution.

Benefit accruals as of August 1, 1986. If you made a special choice, on a return filed for a tax year beginning before 1989, you can exclude from the tax a prorated part of a distribution that is related to your accrued benefits on August 1, 1986. To have made this special choice, your accrued benefit as of August 1, 1986, must have exceeded $562,500. For more information, see the instructions for Part IV of Form 5329.

Form 5329. You must file a Form 5329, *Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts*, if you receive excess distributions from a qualified retirement plan, whether or not you owe tax.

Tax for Failure to Make Minimum Distribution

If you reach age 70½ ***after 1987,*** qualified employee retirement plans, qualified annuity plans, deferred compensation plans under section 457, and tax-sheltered annuity programs (for benefits accruing after 1986) must begin to make distributions to you no later than April 1 of the year following the calendar year in which you reach age 70½. It does not matter whether you are retired. This rule is effective for distribution years beginning after 1988; that is, for distributions required to be made by April 1, 1990.

Exceptions. The above rule does not apply to governmental plans or church plans. Nor does it apply to any individual (unless a 5% owner) who reached age 70½ before 1988.

In these cases, distributions must begin no later than April 1 of the calendar year following the later of:

1) The calendar year in which you reach age 70½, or
2) The calendar year in which you retire.

5% owners. If you are a 5% (or more) owner of the company maintaining the plan, distributions to you must begin by April 1 of the calendar year after the year in which you reach 70½, regardless of when you retire.

Also, a later effective date for the above rule may apply to plans maintained under a union-management agreement put into effect before March 1, 1986 (but the rule will be effective not later than plan years beginning after 1990).

Minimum distributions. You must either:

- Receive your entire interest in the plan by the required beginning date, as explained above, or
- Begin receiving regular periodic distributions by that date in an amount large enough to use up the entire interest over your life expectancy or over the joint life expectancies of you and a designated surviving beneficiary (or over a shorter period).

Additional information. For more information on this rule, see *Tax for Not Making Minimum Distributions* in Publication 575.

Tax on failure to distribute. If you do not receive these required minimum distributions, you, as the payee, are subject to an excise tax equal to 50% of the difference between the amount that was required to be distributed and the amount that was actually distributed during the tax year. You can get this excise tax excused if you establish that the shortfall in distributions was due to reasonable error and that you are taking reasonable steps to remedy the shortfall.

Form 5329. You must file a Form 5329 if you owe a tax because you did not receive a minimum required distribution from your qualified retirement plan.

Disability Income

Generally, if you retire on disability, you must report your pension or annuity as income.

If you were 65 or older at the end of the tax year, or if you were under 65, retired on permanent and total disability, and you received taxable disability income, you may be able to claim the credit for the elderly or the disabled. See Chapter 34 for more information about the credit.

Taxable Disability Pensions or Annuities

Whether you must report your disability pension or annuity as income depends on how your pension plan is financed.

Generally, you must report as income any amount you receive for your disability through an accident or health insurance plan that is paid for by your employer. However, certain payments may not be taxable to you. These payments are discussed in Chapter 13.

If the plan does not say that you must pay a specific part of the cost of the disability pension, your employer is considered to provide the disability pension. You must report on your return all payments you receive.

If the plan says that you must pay a specific part of the cost of your disability pension, any amounts you receive that are due to your payments to the disability pension are not taxed. You do not report them on your return. They are treated as benefits received under an accident or health insurance policy that you bought. You generally must include in income

the rest of the amounts you receive that are due to your employer's payments.

If you retired on disability during the past year, any lump-sum payment for accrued annual leave that you received when you retired is a salary payment. The payment is not a disability payment. You should report it as wages in the year you received it.

If part of your disability pension is worker's compensation, that part is not taxed. If you die, the part of your survivor's benefit that represents a continuation of the worker's compensation is not taxed.

Your employer should be able to give you specific details about your pension plan and to tell you the amount, if any, you paid for your disability pension.

How to report. You must report all your taxable disability income on line 7, Form 1040, or line 7, Form 1040A, until you reach minimum retirement age.

If you retired on disability and had made contributions to the plan, payments you receive are taxable under the General Rule or Simplified General Rule (discussed earlier) beginning with the day after you reach minimum retirement age.

Minimum retirement age generally is the age at which you may first receive a pension or annuity whether or not you are disabled.

Military and Certain Government Disability Pensions

Generally, you must report disability pensions as income. But certain military and government disability pensions are not taxable. If your disability pension is taxable, you may be able to take the credit for the elderly or for the disabled. See Chapter 34 for more information about the credit.

Members of government services. Generally, you must report on your return any disability payments you receive for personal injuries or sickness resulting from active service in the armed forces of any country or in the National Oceanic and Atmospheric Administration, the Public Health Service, or the Foreign Service. However, if you receive a disability pension based on percentage of disability, you do not include the disability payments in your income if:

1) You were entitled to receive a disability payment before September 25, 1975,
2) You were a member of a government service (or its reserve component), or were under a binding written commitment to become a member on September 24, 1975,
3) You receive disability payments for a "combat-related injury," or
4) You would be entitled to receive disability compensation from the Department of Veterans Affairs (VA) if you filed an application for it.

Combat-related injury means personal injury or sickness that:

1) Directly results from armed conflict,
2) Takes place while you are engaged in extra-hazardous service,
3) Takes place under conditions simulating war, including training exercises such as maneuvers, or
4) Is caused by an instrumentality of war.

Disability based on years of service. If you receive a disability pension based on years of service, you generally must include it in your income. But if you fall into one of the four categories listed above under *Members of government services*, do not include in income the part of your pension that you would have received if the pension had been based on percentage of disability. You must include the rest of your pension in income. If part of your disability pension is taxable, you may be able to take the credit for the elderly or for the disabled. See Chapter 34 for more information about the credit.

Terrorist attack. You do not include disability payments in income if you receive them for injuries directly resulting from a violent attack that occurred while you were a U.S. government employee performing official duties outside the United States. For your disability payments to be tax exempt, the Secretary of State must determine that the attack was a terrorist attack.

Disability benefits you receive from the VA are not included in your gross income. If you are a military retiree and do not receive your disability benefits from the VA, do not include in income the amount of disability benefits equal to the VA benefits to which you are entitled.

If you retire from the armed services (based on years of service) and at a later date are given a retroactive service-connected disability rating by the VA, do not include in income for the retroactive period the part of your retirement pay you would have been entitled to receive from the VA during that period. However, you must include in income any lump-sum readjustment payment you received on release from active duty, even though you are later given a retroactive disability rating by the VA.

Purchased Annuities

If you purchased an annuity contract from a commercial organization, such as an insurance company, you must use the General Rule to figure the part of each annuity payment you receive that is not taxed. For more information, get Publication 939, *Pension General Rule (Nonsimplified Method)*.

Sale of annuity. Gain on the sale of an annuity contract before its maturity date is ordinary income to the extent that the gain is due to interest accumulated on the contract.

Tax on early withdrawals. A penalty tax of 10% is imposed on amounts you withdraw from your deferred annuity contract before age 59½. This is referred to as the section 72(q) tax. For exceptions to this penalty, see *Tax on early withdrawals from deferred annuity contracts* in Publication 575.

12. Social Security and Equivalent Railroad Retirement Benefits

Important Change for 1990

Using Form 1040A. Beginning with the 1990 return, you may choose to report taxable benefits on Form 1040A if you do not have to file Form 1040 for any other reason. This chapter will include references to lines on Form 1040A where appropriate.

If you received social security or equivalent railroad retirement benefits in 1990, part of the amount you received may be taxable. This chapter discusses how to figure if any of your benefits are taxable and how to report any taxable benefits on your return. Also included are some examples that show how the tax law applies to these benefits.

Note. This chapter does not discuss the tax rules that apply to railroad retirement benefits other than the social security equivalent portion of tier 1 benefits (including special guaranty benefits). The tax rules that apply to the non-social security equivalent portion of tier 1 benefits, and to tier 2 benefits, vested dual benefits, and supplemental annuity benefits, are discussed in Chapter 11. Also see Publication 575, *Pension and Annuity Income (Including Simplified General Rule)*.

Also not discussed are the tax rules that apply to foreign social security benefits. These benefits are taxable as a pension or annuity unless exempt from U.S. tax under a treaty. For example, social security benefits received by a U.S. citizen or resident from the Federal Republic of Germany or the United Kingdom are taxable under the tax rules discussed in Chapter 11.

Form SSA–1099. If you received or repaid social security benefits during 1990, you will receive Form SSA–1099, *Social Security Benefit Statement*. An IRS Notice 703 will be enclosed with your Form SSA–1099. This notice includes a worksheet you can use to determine if any of your benefits may be taxable. Keep this notice for your own records; do *not* mail it to either the IRS or the SSA.

Every person who received social security benefits will receive a Form SSA–1099, even if the benefit is combined with another person's in a single check. If you receive benefits on more than one social security record, you may get more than one Form SSA–1099.

Form RRB–1099. If you received or repaid the social security equivalent portion of tier 1 railroad retirement benefits or special guaranty benefits during 1990, you will receive Form RRB–1099, *Statement for Recipients of Payments by the Railroad Retirement Board*.

Each beneficiary will receive his or her own Form RRB–1099. If you receive benefits on more than one railroad retirement record, you may get more than one Form RRB–1099.

For more information about Form SSA–1099 and Form RRB–1099, including explanations of the items shown in each box on the forms, see Publication 915, *Social Security Benefits and Equivalent Railroad Retirement Benefits.*

Taxation of Benefits

In figuring if any of your benefits are taxable, use the amount shown in Box 5 of the Form SSA–1099 or Form RRB–1099 you received. If you received more than one form, add together the amount in Box 5 of each form.

Who is taxed. Benefits, if taxable, must be included in the taxable income of the person who has the legal right to receive the benefits. For example, if you and your child receive benefits, but the check for your child is made out in your name, you must use only your portion of the benefits in figuring if any part is taxable to you. The portion of the benefits that belongs to your child must be added to your child's other income to see if any of those benefits are taxable.

Are Any of Your Benefits Taxable?

If the only income you received during 1990 was your social security or equivalent railroad retirement benefits, your benefits are not taxable and you probably do not have to file a return.

Base amount. If you received income during 1990 in addition to social security or equivalent railroad retirement benefits, your benefits are generally not taxable if your income is not more than the following ***base amounts***:

- $25,000 if you are single.
- $25,000 if you are married, do not file a joint return and ***did not*** live with your spouse at any time during 1990.
- $32,000 if you are married and file a joint return.
- $–0– if you are married, do not file a joint return and ***did*** live with your spouse at any time during 1990.

Note. The base amount of $25,000 is for any eligible person whose filing status or situation does not meet either the $32,000 (married filing jointly) or the $–0– (married filing separately) category. This includes heads of household and qualifying widow(er)s, as well as the first two situations listed above.

Joint return. If you are married and file a joint return for 1990, you and your spouse must combine your incomes and your benefits when figuring if any of your combined benefits are taxable. Even if your spouse did not receive any benefits, you must add your spouse's income to yours when figuring if any of your benefits are taxable.

You can use the worksheet in the following example, substituting your own amounts, to figure whether your income is more than the base amount for your filing status. Similar worksheets are included in your Form SSA–1099 or Form RRB–1099 package.

Example. You and your spouse are filing a joint return for 1990, and you both received social security benefits during the year. In January 1991, you received a Form SSA–1099 showing net benefits of $6,600 in Box 5. Your spouse received a Form SSA–1099 showing $2,400 in Box 5. You also received a taxable pension of $10,000 and interest income of $500 during 1990. You did not have any tax-exempt interest in 1990. Your benefits are not taxable for 1990 because your income, as figured in the following worksheet, is not more than $32,000.

A	Write in the amount from ***Box 5*** of all your Forms SSA–1099 and RRB–1099. Include the full amount of any lump-sum benefit payments received in 1990, attributable to both 1990 and earlier years, if you choose to report the full amount for the 1990 tax year. (If you received more than one form, combine the amounts from Box 5 and write in the total.)	A $ 9,000
	Note: If the amount on line A is zero or less, stop here; none of your benefits are taxable this year.	
B	Divide the amount on line A by 2 and write in the result	B 4,500
C	Add up your taxable pensions, wages, interest, dividends, and other taxable income and write in the total	C 10,500
D	Write in any tax-exempt interest, such as interest on municipal bonds	D –0–
E	Add lines B, C, and D and write in the total	E 15,000
	Note: If the amount on line E is not more than the base amount for your filing status, none of your benefits are taxable this year.	

Repayments. Any repayment of benefits you made during 1990 is automatically subtracted from the gross benefits you received in 1990. It does not matter if the repayment you made in 1990 was for a benefit you received before 1990. Your gross benefits are shown in Box 3 of Form SSA–1099 or RRB–1099 and your repayments are shown in Box 4. The amount in Box 5 shows your net benefits for 1990 (Box 3 minus Box 4). This is the amount you will use to figure if any of your benefits are taxable.

How Much Is Taxable

Your social security or equivalent tier 1 benefits may be taxable, depending on the amount of your income and your filing status.

If you used Notice 703 and found that some of your benefits are taxable, figure the amount that is actually subject to tax. This is the ***smaller*** of:

1) One-half of the ***net benefits*** you received, or
2) One-half of the amount by which the sum of your ***modified AGI (adjusted gross income)*** plus one-half of your net benefits is more than the ***base amount*** (explained earlier) for your filing status.

This means that the most that will be taxable is *one-half* of the net benefits you received.

Net benefits. This is the amount that is shown in Box 5 of Form SSA–1099 and Box 5 of Form RRB–1099. If you received more than one form, you must add the amounts in Box 5 of each form to get your total net benefits.

Modified adjusted gross income. This is the sum of your adjusted gross income plus any ***tax-exempt interest*** (see later) you received in 1990. Your adjusted gross income is figured without including any of your social security or equivalent benefits and without subtracting:

- The interest exclusion for certain Series EE savings bonds that you redeem in the year you pay for qualified education expenses,
- The foreign earned income exclusion and the foreign housing exclusion or deduction,
- The exclusion of income from U.S. possessions (for 1990, this applied only to bona fide residents of American Samoa), or
- The exclusion of income from Puerto Rico by bona fide residents of Puerto Rico.

Form 1040EZ. If you usually file Form 1040EZ, figure modified adjusted gross income by adding:

Adjusted gross income (line 3, Form 1040EZ),
plus
Any tax-exempt interest received in 1990.

Form 1040A. If you usually file Form 1040A, leave line 13b, Form 1040A, blank, and figure modified adjusted gross income by adding:

Adjusted gross income (line 16, Form 1040A),
plus
Any qualified savings bond interest exclusion,
plus
Any tax-exempt interest received in 1990.

Form 1040. If any of your benefits are taxable, you may file either Form 1040A or Form 1040—you cannot use Form 1040EZ to report taxable benefits. Leave line 21b, Form 1040, blank, and figure modified adjusted gross income by adding:

Adjusted gross income (line 31, Form 1040),
plus
Any qualified savings bond interest exclusion, foreign earned income exclusion, foreign housing exclusion or deduction, or exclusion of income from U.S. possessions or Puerto Rico,
plus
Any tax-exempt interest received in 1990.

Figuring your IRA deduction. If you make contributions to an individual retirement arrangement (IRA) in 1990, your allowable deduction for those contributions is subtracted from your gross income in arriving at your modified AGI. Therefore, you must figure your IRA deduction before you can figure your taxable benefits.

If your deductible IRA contributions limit is reduced because you or your spouse are covered by a retirement plan at work, you must use the special worksheets in Publication 590, *Individual Retirement Arrangements (IRAs)*, to figure your IRA deduction and taxable benefits to be reported on your return.

Tax-exempt interest. Even though you do not include tax-exempt interest in income, you must enter any tax-exempt interest you received on line 8b, Form 1040, or Form 1040A. You must add this interest to your adjusted gross income to arrive at your modified adjusted gross income. Interest you receive from municipal bonds and tax-exempt interest distributions you receive from mutual funds are examples of tax-exempt interest.

Lump-sum benefits. If you received a lump-sum (or retroactive) payment of benefits during 1990 that is for benefits you should have received before 1990, it will be included in Box 3 of your Form SSA–1099 or Form RRB–1099. Box 3 will not include benefits you received in 1990 that were for months before December 1983, because they are not taxable.

Special election. Generally, you include a lump-sum benefit payment in total benefits for the year in which you receive it. However, if you receive a lump-sum benefit payment in 1990 that is for one or more earlier years, you can choose to treat these benefits as received in the earlier year. You do this by figuring whether any part of the benefits is taxable based on the earlier year's income. Any part that is taxable is then added to your taxable benefits for the current year and the total is included in your current year's income.

For more information on lump-sum benefits, see Publication 915.

Estimated tax. Because tax is not withheld from social security benefits or equivalent railroad retirement benefits, you may have to make estimated tax payments during the year. See Chapter 5 for more information on estimated tax.

How to Report

Report your taxable benefits on Form 1040 or Form 1040A. You ***cannot*** use Form 1040EZ. Report your net benefits (the amount in Box 5 of your Form SSA–1099 or RRB–1099) on line 21a, Form 1040, or line 13a, Form 1040A. Report the taxable part (from the last line of the worksheet) on line 21b, Form 1040, or line 13b, Form 1040A.

To help you figure your taxable benefits, use the worksheet in the Form 1040 or Form 1040A instruction package, as long as you are not required to use the Publication 590 worksheets (see *Figuring your IRA deduction,* earlier). Publication 915 also has a worksheet (Worksheet #1) you can use. However, if you exclude interest from U.S. savings bonds under the Education Savings Bond Program, or if you take the foreign earned income exclusion, the foreign housing exclusion or deduction, the exclusion of income from U.S. possessions, or the exclusion of income from Puerto Rico by bona fide residents of Puerto Rico, you ***must*** use Worksheet #1 in Publication 915 (unless you are required to use the Publication 590 worksheets).

Lump-sum payment. If you received a lump-sum benefit payment in 1990 that is for one or more earlier years and choose to treat the payment as if it were received in those years, you ***must*** use the worksheets in Publication 915. Otherwise, you should treat the amount as if it were fully attributable to 1990 and include it in your total benefits received during that year.

Examples

Following are a few examples you can use as a guide to figure if any of your benefits are taxable.

Example 1. George White is single and usually files Form 1040. During 1990, he received the following income:

Fully taxable pension	$18,600
Wages from part-time job	9,400
Interest income	990
Total	$28,990

George also received social security benefits during 1990. The Form SSA–1099 he received in January 1991 shows $7,200 in Box 3, $1,220 in Box 4, and $5,980 in Box 5. To figure his taxable benefits, George completes the worksheet shown here. A similar worksheet appears in the Form 1040 tax instructions.

Social Security and Equivalent Railroad Retirement Benefits Worksheet (Keep for your records)

Check only one box

- ☑ **A.** Single—enter $25,000 on line 7 below.
- ☐ **B.** Married filing a joint return—enter $32,000 on line 7 below.
- ☐ **C.** Married not filing a joint return and lived with your spouse at any time during the year—enter –0– on line 7 below.
- ☐ **D.** Married not filing a joint return and **DID NOT** live with your spouse at any time during the year—enter $25,000 on line 7 below.

1. Enter the total amount from **Box 5** of **ALL** your **Forms SSA–1099** and **Forms RRB–1099** (if applicable)	5,980
Note. *If line 1 is zero or less, stop here; none of your benefits are taxable. Otherwise, go on to line 2.*	
2. Divide the amount on line 1 by 2	2,990
3. Add the amounts on Form 1040, lines 7, 8a, 8b through 20, plus line 22. Do not include here any amounts from lines 16a or 17a of Form 1040, or from Box 5 of Forms SSA–1099 or RRB–1099	28,990
4. Add lines 2 and 3	31,980
5. Enter the amount from Form 1040, line 30	–0–
6. Subtract line 5 from line 4	31,980
7. Enter: $25,000 if you checked Box A or D, or $32,000 if you checked Box B, or –0– if you checked Box C	25,000
8. Subtract line 7 from line 6. Enter the result, but not less than zero	6,980
Note. *If line 8 is zero, stop here. None of your benefits are taxable. Do not enter any amounts on Form 1040, lines 21a or 21b, unless you checked Box D above. If you checked Box D, enter –0– on line 21b and write "D" to the left of line 21a. If line 8 is more than zero, go on to line 9.*	
9. Divide the amount on line 8 by 2	3,490
10. **Taxable benefits.** • First, enter on Form 1040, line 21a, the amount from line 1 above. • Then, compare amounts on lines 2 and 9 above, and enter the **smaller** of the two amounts on this line and also on Form 1040, line 21b	2,990

The amount on line 10 of George's worksheet shows that $2,990 of his social security benefits are taxable. On line 21a of his Form 1040, George enters his net benefits of $5,980. On line 21b, he enters his taxable part of $2,990.

Example 2. Joe and Betty Johnson are married and are filing a joint return on Form 1040A for 1990. Joe is retired and receives a fully taxable pension of $26,000. Joe and Betty both received social security benefits in 1990. Joe's Form SSA–1099 shows $6,800 in Box 3, $1,100 in Box 4, and $5,500 in Box 5. Betty's Form SSA–1099 shows $3,500 in Box 3 and the same amount in Box 5. The only other income Joe and Betty had in 1990 was $2,400 in interest income. They figure their taxable social security benefits by completing the worksheet shown below. They enter $9,000 on line 13a, Form 1040A, and $1,450 on line 13b, Form 1040A.

Social Security and Equivalent Railroad Retirement Benefits Worksheet (Keep for your records)

Check only one box.

- ☐ **A.** Single—enter $25,000 on line 7 below.
- ☑ **B.** Married filing a joint return—enter $32,000 on line 7 below.
- ☐ **C.** Married not filing a joint return and lived with your spouse at any time during the year—enter –0– on line 7 below.
- ☐ **D.** Married not filing a joint return and **DID NOT** live with your spouse at any time during the year—enter $25,000 on line 7 below.

1. Enter the total amount from **Box 5** of **ALL** your **Forms SSA–1099** and **Forms RRB–1099** (if applicable)	9,000
Note. *If line 1 is zero or less, stop here; none of your benefits are taxable. Otherwise, go on to line 2.*	
2. Divide the amount on line 1 by 2	4,500
3. Add the amounts on Form 1040A, lines 7, 8a, 8b, 9 through 12. Do not include here any amounts from lines 10a, 11a, or 13a of Form 1040A, or from Box 5 of Forms SSA–1099 or RRB–1099	30,400
4. Add lines 2 and 3	34,900
5. Enter the amount from Form 1040A, line 15c	–0–
6. Subtract line 5 from line 4	34,900
7. Enter: $25,000 if you checked Box A or D, or $32,000 if you checked Box B, or –0– if you checked Box C	32,000
8. Subtract line 7 from line 6. Enter the result, but not less than zero	2,900
Note. *If line 8 is zero, stop here. None of your benefits are taxable. Do not enter any amounts on Form 1040A, lines 13a or 13b, unless you checked Box D above. If your checked Box D, enter –0– on line 13b and write "D" to the left of line 13a. If line 8 is more than zero, go on to line 9.*	
9. Divide the amount on line 8 by 2	1,450
10. **Taxable benefits.** • First, enter on Form 1040A, line 13a, the amount from line 1 above. • Then, compare amounts on lines 2 and 9 above, and enter the **smaller** of the two amounts on this line and also on Form 1040A, line 13b	1,450

Repayments More Than Gross Benefits

In some situations, your Form SSA–1099 or Form RRB–1099 will show that the total benefits you repaid (Box 4) is more than the gross benefits (Box 3) you received. If this occurred, your net benefits in Box 5 will be a negative figure and none of your benefits will be taxable. If you receive more than one form, a negative figure in Box 5 of one form is used to offset a

positive figure in Box 5 of another form. If you have any questions about this negative figure, contact your local Social Security Administration office or your local Railroad Retirement Board field office.

Joint return. If you and your spouse file a joint return, and your Forms SSA–1099 or Forms RRB–1099 show that your repayments are more than your gross benefits, but your spouse's are not, subtract the amount in Box 5 of your form from the amount in Box 5 of your spouse's form to get your net benefits when figuring if your combined benefits are taxable.

Example. John and Mary are married and file a joint return for 1990. John received Form SSA–1099 showing $3,000 in Box 5. Mary also received Form SSA–1099 and the amount in Box 5 was ($500). John and Mary will use $2,500 ($3,000 minus $500) as the amount of their net benefits when figuring if any of their combined benefits are taxable.

Repayment of benefits received in an earlier year. If the sum of the amount shown in Box 5 of all of your Forms SSA–1099 and Forms RRB–1099 is a negative figure and part or all of this negative figure is for benefits you included in gross income in any earlier year after 1983, you can take an itemized deduction on Schedule A, Form 1040, for the amount of the negative figure that represents those benefits. This deduction, if $3,000 or less, is subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions.

If this deduction is more than $3,000, you should figure your tax two ways:

1) Figure your tax for 1990 with the itemized deduction. This deduction is ***not*** subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions.
2) Figure your tax for 1990 without the deduction. If a portion of the negative figure represents a repayment of 1984 benefits, you must first recompute your 1984 tax, reducing your 1984 social security benefits by that portion. Recompute your 1985, 1986, etc. tax in the same manner, using any portion of the negative figure that represents a repayment of benefits for those years. Reduce your 1990 tax, figured without the deduction, by the total decrease in your 1984, 1985, 1986, 1987, 1988, or 1989 tax as recomputed.

Compare the tax figured in methods (1) and (2). Your tax for 1990 is the lesser of the two amounts. If method (1) results in less tax, take the itemized deduction on Schedule A (Form 1040). If method (2) results in less tax, claim a credit for the applicable amount on line 61 of Form 1040 and write "I.R.C. 1341" in the margin to the left of line 61. If both methods produce the same tax, deduct the repayment in full on Schedule A.

13. Other Income

Important Change

Jury duty pay. If you are required to give your jury duty pay to your employer because your employer continues to pay your salary while you serve on the jury, you can, beginning in 1987, deduct the amount repaid as an adjustment to gross income, rather than as an itemized deduction. See *Jury duty pay,* later.

You must include on your tax return all income you receive in the form of money, property, and services that is not exempt from tax. This chapter discusses many items of taxable income, as well as some major items that are not taxable.

Miscellaneous Taxable Income

This section begins with brief discussions of numerous income items, arranged in alphabetical order. These discussions are followed by other taxable income items which are discussed in greater detail as follows:

Bartering
Recoveries (including state income tax refunds)
Repayments
Royalties

Note. When you report miscellaneous taxable income on line 22 of Form 1040, write a brief description of the income on the dotted line next to line 22.

Activity not for profit. You must include on your return income from an activity not for profit. An example of this type of activity would be a hobby or a farm you operate mostly for recreation and pleasure. Deductions for expenses related to the activity are limited, cannot total more than the income you report, and can be taken only if you itemize deductions on Schedule A (Form 1040).

The activity will be presumed to have been for profit if it results in a profit in at least 3 out of 5 consecutive tax years. However, for the breeding, training, showing, or racing of horses, the activity must result in a profit in at least 2 out of 7 consecutive tax years. If the activity meets this test, it is presumed to be carried on for profit and the limits will not apply.

If you have engaged in an activity for less than 3 years, you can postpone the determination that the activity is not for profit by filing Form 5213, *Election To Postpone Determination.* Get Publication 535, *Business Expenses,* for more information.

Alaska oil royalties. If you were a resident of Alaska and qualified to receive a payment from Alaska's mineral income fund (Alaska Permanent Fund dividends), you must report this amount on line 22, Form 1040. The state of Alaska will send you a Form 1099–MISC which shows this amount. The IRS will receive a copy of the Form 1099.

Alimony. Include in income on line 11, Form 1040, any alimony payments you receive. Amounts you receive for child support are not income to you. Alimony and child support payments are discussed in Chapter 20.

Allowances and reimbursements. If you receive travel, transportation, or other allowances or reimbursements from your employer, see Chapter 28.

Cancelled debt. A cancelled debt, or a debt paid for you by another person, is generally income to you and must be reported on line 22, Form 1040. A discount offered by a financial institution for the prepayment of a mortgage loan is income from the cancellation of a debt. However, you have no income from the cancellation of a debt if the cancellation, or the payment by another person, is intended by the other person as a gift to you.

If your debt is cancelled in a bankruptcy case (title 11) or when you are insolvent, the discharge of debt is not income. Get Publication 908, *Bankruptcy and Other Debt Cancellation.*

Cancellation of student loan. You do not have income if your student loan is cancelled because you agreed to certain conditions to obtain the loan and then performed the services required. Under the terms of the loan you must be required to work for a specified period of time in certain professions for one of a broad class of employers. To qualify, the loan must have been made by:

1) The government—federal, state, or local, or an instrumentality, agency, or subdivision thereof.
2) A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law.
3) An educational organization under an agreement with an entity described in (1) or (2) that provided the funds to the institution to make the loan.

Cancellations of student loans under section 465 of the Higher Education Act of 1965 also are not income.

Court awards and damages. To determine if settlement amounts you receive by compromise or judgment must be included in income, you must consider the item that the settlement replaces. Include the following as ordinary income:

1) Interest on any award.
2) Compensation for lost wages or lost profits.
3) Punitive damages awarded in cases not involving physical injury or sickness.
4) Amounts received in settlement of pension rights (if you did not contribute to the plan).
5) Damages for:
   a) Patent or copyright infringement.
   b) Breach of contract.
   c) Interference with business operations.

Do not include as income compensatory damages for the following:

1) Personal injury or sickness (whether received in a lump sum or installments).
2) Damage to your character.
3) Alienation of affection.
4) Surrender of custody of a minor child.

Get Publication 525, *Taxable and Nontaxable Income*, for additional information.

Estate and trust income. An estate or trust, unlike a partnership, may have to pay federal income tax. If you are a beneficiary of an estate or trust, you are taxed on your share of its income. However, there is never a double tax. Estates and trusts file their returns on Form 1041, *U.S. Fiduciary Income Tax Return*, and report your share of the income on Schedule K–1 of Form 1041.

Current income required to be distributed. If you are the beneficiary of a trust that must distribute currently all of its income, you must report your share of the distributable net income whether or not you have actually received it.

Current income not required to be distributed. If you are the beneficiary of an estate or trust and the fiduciary has the choice of whether to distribute all or a part of the current income, you must report all income that is required to be distributed to you, whether or not it is actually distributed, plus all other amounts actually paid or credited to you, to the extent of your share of distributable net income.

How to report estate and trust income. Each item of income is treated the same for you as for the estate or trust. If it is dividend income for the trust, it is the same for you.

The fiduciary of the estate or trust must tell you the type of items making up your share of the estate or trust income and any credits you are allowed on your individual income tax return.

Losses of estates and trusts generally are not deductible by the beneficiaries.

Grantor trust. Income earned by a grantor trust is taxable to the grantor, not the beneficiary. This rule applies if the property put into the trust will revert (be returned) to the grantor or the grantor's spouse. Generally, for transfers after March 1, 1986, a trust is a grantor trust if the grantor has a reversionary interest valued (at the date of transfer) at more than 5% of the value of the transferred property. For transfers in trust made before March 2, 1986, a trust was a grantor trust if it was expected that the property would revert to the grantor within 10 years.

Fees. Include all fees for your services in gross income. Examples of these fees are amounts you receive for services as:

1) A corporation director.
2) An executor or administrator of an estate.
3) A notary public.
4) An election precinct official.

Free tour. A free tour you receive from a travel agency for organizing a group of tourists must be included in income on line 22, Form 1040, or on Schedule C (Form 1040) at the fair market value of the tour. You cannot deduct your expenses in serving as the voluntary leader of the group at the group's request.

Gambling winnings. You must include your gambling winnings in income on line 22, Form 1040. If you itemize your deductions on Schedule A (Form 1040), you can deduct gambling losses you had during the year, but only up to the amount of your winnings.

Winnings from lotteries and raffles are gambling winnings. In addition to cash winnings, you must include in income bonds, cars, houses, and other noncash prizes at their fair market value.

Note. If you win a state lottery prize payable in installments, you must include in gross income the annual payments and any amount you receive designated as "interest" on the unpaid installments.

Hobby losses. Losses from a hobby are not deductible from other income. A hobby is an activity from which you do not expect to make a profit. See *Activity not for profit, earlier.*

Note. If you collect stamps, coins, or other items as a hobby for recreation and pleasure, and you sell any of the items, your gain is taxable as a capital gain. (See Chapter 16.) However, if you sell items from your collection at a loss, you cannot deduct a net loss.

Illegal income, such as stolen or embezzled funds, must be included in gross income on line 22, Form 1040, or on Schedule C (Form 1040).

Indian fishing rights. If you are a member of a qualified Indian tribe that has fishing rights secured by treaty, executive order, or an Act of Congress as of March 17, 1988, do not include in income amounts you receive from activities related to those fishing rights. The income is not subject to income tax, self-employment tax, or employment taxes.

Investment clubs. An investment club is a group of friends, neighbors, business associates, or others who pool limited or stated amounts of funds to invest in stock or other securities. The club may or may not have a written agreement, charter, or by-laws. Usually the group operates informally with members pledging a regular amount to be paid into the club monthly. Some clubs have a committee that gathers information on securities, selects the most promising, and recommends that the club invest in them. Other clubs rotate the investigatory responsibilities among all their members. Most require all members to vote for or against all investments, sales, exchanges, or other transactions.

How the income from an investment club is reported on your tax return depends on how the club operates. Most clubs operate as partnerships and are treated as such for federal tax purposes. Others operate as corporations, trusts, or associations taxed as corporations.

For more information about investment clubs, get Publication 550, *Investment Income and Expenses.*

Jury duty pay you receive must be included in income. If you are required to give the pay to your employer because your employer continues to pay your salary while you serve on the jury, you can deduct the amount turned over to your employer as an adjustment to income. Include the amount you repay your employer on line 30, Form 1040, and write "Jury pay" and the amount on the dotted line next to line 30.

Kickbacks. You must include in income on line 22, Form 1040, or on Schedule C (Form 1040), kickbacks, side commissions, push money, or similar payments you receive.

Example. You are a car salesperson and help arrange car insurance for buyers. Insurance brokers kick back part of their commissions to you for referring customers to them. You must include the kickbacks in your income.

Note received for services. If your employer gives you a note as payment for your services, you must include the fair market value (usually the discount value) of the note in income as wages for the year you receive it. When you later receive payments on the note, part of each payment is a recovery of the fair market value that you previously included in income. Do not include that part in income again. Include the rest of the payment in income in the year of payment.

Prizes and awards. If you win a prize in a lucky number drawing, television or radio quiz program, beauty contest, or other event, you must include it in income. For example, if you win a $50 prize in a photography contest, you must report this income on line 22, Form 1040.

Employee cash awards or bonuses. Cash awards or bonuses given to you by your employer for good work or suggestions must be included in income. However, certain employee awards can be excluded from income. See *Employee achievement awards,* later.

Prizes and awards in goods or services must be included in income at their fair market value. If you refuse to accept a prize, do not include it in income.

Pulitzer, Nobel, and other prizes awarded in recognition of past accomplishments—in religious, charitable, scientific, artistic, educational, literary, or civic fields—are not included in income if ***all*** of the following requirements are met:

1) You were selected without any action on your part to enter the contest or proceeding.
2) You are not required to perform substantial future services as a condition to receiving the prize or award.
3) The prize or award is transferred directly to a governmental unit or tax-exempt charitable organization as designated by you.

Get Publication 525 for more information about the conditions that apply to the transfer.

Property purchased from employer. If you buy shares of stock or other property from your employer for less than fair market value, you ordinarily must include in income, as wages, the difference between their fair market value at the time you bought them and the amount you paid. You also must include in income the fair market value of any stock you received free from your employer. See *Property received for services* in Chapter 6.

Sale of personal items. If you sell an item that you owned for personal use, such as a car, refrigerator, furniture, stereo, jewelry, or silverware, a gain is taxable as a capital gain reported on Schedule D (Form 1040). A loss is not deductible.

However, if you sell an item that you held for investment, such as gold or silver bullion, coins, or gems, a gain is taxable as a capital gain and a loss is deductible as a capital loss.

Bartering

Bartering is an exchange of property or services.

Fair market value. You must include in income, at the time received, the fair market value of property or services you receive in bartering. If you exchange services with another person and you both have agreed ahead of time as to the value of the services, that value will be accepted as fair market value

unless the value can be shown to be otherwise.

Example 1. You are a self-employed attorney and perform legal services for a client, a small corporation. The corporation gives you shares of its stock as payment for your services. You must include in income the fair market value of the shares on Schedule C (Form 1040) in the year that you receive them.

Example 2. You are a member of a barter club. The club uses "credit units" as a means of exchange. It adds credit units to your account for goods or services you provide to members, which you can use to purchase goods and services offered by other members of the barter club. The club subtracts credit units from your account when you receive goods or services from other members. You must include in income the value of credit units that are added to your account, even though you may not actually receive goods or services from other members until a later tax year.

Example 3. You own an apartment building and an artist gives you a work of art that the artist created in return for 6 months' rent-free use of an apartment. You must report as rental income on Schedule E (Form 1040) the fair market value of the art work, and the artist must report as income on Schedule C (Form 1040) the fair rental value of the apartment.

Barter exchange. If you exchanged property or services through a barter exchange, you may receive a statement from the barter exchange (Form 1099–B, *Statement for Recipients of Proceeds From Broker and Barter Exchange Transactions*, or a similar statement). You should receive the statement by January 31, 1991, and it will generally show the value of cash, property, services, credits, or scrip you received from exchanges during the year. The Internal Revenue Service (IRS) will get a copy of Form 1099–B.

Backup withholding. The income you receive from bartering is generally not subject to withholding. However, backup withholding will apply in certain circumstances to ensure that income tax is collected on this income.

If you join a barter exchange, you must certify under penalties of perjury that your social security or employer identification number is correct and that you are not subject to backup withholding. If you do not make this certification, backup withholding may begin immediately. The barter exchange will give you a Form W–9, *Request for Taxpayer Identification Number and Certification*, or a similar form, for you to make this certification. For more information, see *Backup Withholding* in Chapter 5.

Reporting the tax withheld. If tax is withheld from your barter income, the barter exchange must give you a Form 1099–B, or similar statement, that indicates the amount of tax withheld.

Partnership Income

A partnership is not a taxable entity. The income, gains, losses, credits, and deductions of a partnership are "passed through" to the partners based on each partner's distributive share of these items.

The partnership must file a return on Form 1065, *U.S. Partnership Return of Income*, and send Schedule K–1 to each partner. In addition, the partnership will send each partner a copy of the *Partner's Instructions for Schedule K–1 (Form 1065)*, to help each partner report his or her share of the partnership's income, credits, deductions, and tax preference items. Do not attach Schedule K–1 (Form 1065) to your Form 1040. Keep it for your records.

For an example of how to report partnership items, see Chapter 38.

For more information on partnerships, get Publication 541, *Tax Information on Partnerships*.

S Corporation Income

In general, an S corporation does not pay tax on its income. Instead, the income and expenses of the corporation are "passed through" to the shareholders.

An S corporation must file a return on Form 1120S, *U.S. Income Tax Return for an S Corporation*, and send Schedule K–1 (Form 1120S) to each shareholder. In addition, the S corporation will send each shareholder a copy of the *Shareholder's Instructions for Schedule K–1 (Form 1120S)* to help each shareholder report his or her share of the S corporation's income, credits, and deductions. Do not attach Schedule K–1 (Form 1120S) to your Form 1040. Keep it for your records.

For more information on S corporations and their shareholders, get Publication 589, *Tax Information on S Corporations*.

Recoveries

A recovery is a return of an amount you deducted or took a credit for in an earlier year. Generally, you must include part or all of the recovered amounts in income in the year the recovery is received. The most common recoveries are refunds, reimbursements, and rebates of deductions itemized on Schedule A (Form 1040). Non-itemized deduction recoveries include such items as payments you receive on previously deducted bad debts, reimbursements not included on your Form W–2 for an employee business expense deducted before 1987, and recoveries on items for which you previously claimed a tax credit.

If you receive recoveries from items that were deducted in 2 or more years, the amount of the recoveries to include in income must be figured separately for each year.

Interest on any of the amounts you recover must be reported as interest income in the year received.

Recovery and expense same year. If the refund or other recovery and the deductible expense occur in the same year, the refund or recovery reduces the deduction and is not reported as income.

Refunds of federal income taxes are not included in income because they are never allowed as a deduction from income.

Recovery attributable to 2 or more years. If you receive a refund or other recovery from one item, such as a real estate tax rebate, that is for amounts you paid in two or more separate years, you must allocate, on a pro rata basis, the recovered amount between the years in which it was paid.

This allocation is necessary to determine the amount of recovery attributable to any earlier years and to determine the amount, if any, of your allowable deduction for this item for the current year. For information on how to compute the allocation, see *Recoveries* in Publication 525.

Tax benefit rule. If you did not derive a tax benefit from your prior year deduction, you do not have to include the amount you received this year in income. This could happen if you were subject to the alternative minimum tax or had credits that reduced your tax liability to zero. For more information, get Publication 525.

Itemized Deduction Recoveries

If you recover any amount that you deducted in an earlier year on Schedule A (Form 1040), you must determine how much, if any, of the recovery to include in income.

Due to changes in the tax law, different computations are needed for the recovery of items deducted after 1986 or before 1987. The discussions in this section apply to recoveries from any year, unless otherwise noted.

Standard deduction. To determine if amounts deducted in 1989 and recovered in 1990 must be included in income, you must know the standard deduction for your filing status in 1989. Standard deduction amounts for 1989 are in Publication 525.

Form 1099–G. If you received a state or local income tax refund in 1990, you may receive a statement, Form 1099–G, *Statement for Recipients of Certain Government Payments*, from the payer of the refund (or credit or offset) by January 31, 1991. The IRS will receive a copy of the Form 1099–G.

No earlier year deduction. If you did not itemize deductions in the year for which you received the recovery, you do not include any of the recovery amount in income.

Recovery limited to deduction. You do not include in income any amount of your recovery that exceeds the amount you deducted in the earlier year. The amount you include in income is limited to the smaller of:

1) The amount deducted on Schedule A (Form 1040), or
2) The amount recovered.

Example. During 1989 you paid $1,200 for medical expenses. From this amount you subtracted $1,000, which was 7.5% of your adjusted gross income. Your taxable income for 1989 was $9,000. Your actual medical expense deduction was $200. In 1990, you received a $500 reimbursement from your medical insurance for your 1989 expenses. The only amount of the $500 reimbursement that must be included in income in 1990 is $200—the amount actually deducted.

Total recoveries included in income. The total amount recovered in 1990 is included in income if certain requirements are met. These requirements are different for amounts deducted after 1986 and amounts deducted before 1987. The recoveries included in income will not be more than the amount deducted. See *Tax benefit rule*, earlier.

Amounts deducted **after 1986** will be included in income if:

1) The recoveries are equal to or less than the amount by which your itemized deductions exceeded the standard deduction for your filing status in the earlier year, and
2) Your taxable income in the earlier year was –0– or more.

Amounts deducted **before 1987** will be included in income if:

1) The recoveries are equal to or less than the earlier year's excess itemized deductions, and

2) Your taxable income in the earlier year was not less than your zero bracket amount.

Enter your state and local income tax refund on line 10, Form 1040, and the total of all other recoveries as other income on line 22, Form 1040.

Example. In 1989, your taxable income was $20,000, the standard deduction for your filing status was $5,000, and you had itemized deductions of $7,000. In 1990, you received the following recoveries for amounts deducted in 1989:

Medical expenses	$200
State and local income tax refund	400
Real estate tax rebate	300
Interest expense	25
Total recoveries	$925

Because your total recoveries are less than the amount your itemized deductions exceeded the standard deduction ($7,000 − 5,000 = $2,000), and your 1989 taxable income was $20,000, you must include your total recoveries in income in 1990. Report the state and local income tax refund of $400 on line 10, Form 1040, and the balance of your recoveries, $525, on line 22, Form 1040.

Total recoveries not included in income. The total recovery that must be included in income is limited to the itemized deductions amount that reduced your tax in the earlier year. (See *Tax benefit rule*, earlier.)

After 1986, you are generally allowed to claim the standard deduction if you do not itemize your deductions. Only your itemized deductions that are more than your standard deduction are subject to the recovery rule. Therefore, include in income the smaller of:

1) Your recoveries, or

2) The amount by which your itemized deductions exceeded the standard deduction.

Example. You filed a joint return in 1989. Your itemized deductions were $7,000. The standard deduction that you could have claimed was $5,200. In 1990 you recover $2,400 of your 1989 itemized deductions. You include $1,800 of the recovery in your 1990 income. This is the smaller of your recoveries ($2,400) or the amount your itemized deductions exceeded the standard deduction ($7,000 − 5,200 = $1,800).

Before 1987. Because only excess itemized deductions before 1987 could reduce tax, the recovered amount of these deductions required to be included in income in 1990 is not more than the excess of your itemized deductions over your zero bracket amount (excess itemized deductions).

The zero bracket amount was not taxed. Therefore, if your taxable income was zero or more, but less than your zero bracket amount, only part of your excess itemized deductions reduced the tax. To figure that part, reduce the excess itemized deductions by the difference between your zero bracket amount and your taxable income. You are not required to include the recovery in income to the extent that it is more than the reduced excess itemized deductions.

See *Recoveries* in Publication 525 if:

1) You recover in 1990 amounts deducted before 1987.

2) You had a negative taxable income in the prior year.

3) You have recoveries from items other than itemized deductions.

4) You were required to itemize deductions in the prior year for which you received the recovery.

5) You received a recovery for an item for which you claimed a tax credit (other than investment credit or foreign tax credit) in a prior year.

6) You were subject to the alternative minimum tax, or you had credits that reduced your tax liability to zero, in the year the deduction was claimed.

7) Your last payment of 1989 estimated state income tax was made in 1990.

Repayments

If you had to repay, during your tax year, an amount that you had included in income in an earlier year because at that time you thought you had an unrestricted right to it, you can deduct the amount you repaid from your income for this year.

Type of deduction. The type of deduction in the year of repayment depends on the type of income you included in the earlier year. For instance, if you repay an amount that you previously reported as a capital gain, deduct the repayment as a capital loss.

Repayment $3,000 or less. If the amount you repaid was $3,000 or less, deduct it from your income on the same form or schedule on which you previously reported it. For example, if you reported it as a capital gain, deduct it on Schedule D (Form 1040). If you reported it as wages or other ordinary income, enter it on line 20, Schedule A (Form 1040).

Repayment over $3,000. If the amount you repaid was more than $3,000, you can take a deduction for the amount repaid, or you can take a credit against your tax. Follow the steps below and compare the results. Use the method (credit or deduction) that results in less tax.

1) Figure your tax for 1990 claiming a deduction for the repaid amount.

2) Figure your tax for 1990 *without* deducting the amount you repaid. Then,

   a) Refigure your tax from the earlier year without including the amount you repaid in 1990.

   b) Subtract the tax in (a) from the tax shown on your return for the earlier year.

   c) Then subtract the answer in (b) from the tax for 1990 figured without the deduction.

How you treat the repayment on your 1990 return depends on which answer above results in less tax.

- If the answer in (1) is less tax, deduct the amount repaid on the same form or schedule on which you previously reported it. Generally, this is line 26 of Schedule A (Form 1040).
- If the answer in (2) is less tax, claim a credit on line 61, Form 1040, and write "I.R.C. 1341" in the margin to the left of line 61.

An example of this computation can be found in Publication 525.

Royalties

Royalties from copyrights, patents, and oil, gas, and mineral properties are taxable as ordinary income.

You generally report royalties on Part I, Schedule E (Form 1040). However, if you hold an operating oil, gas, or mineral interest, or are in business as a self-employed writer, inventor, artist, etc., report gross income and expenses on Schedule C (Form 1040).

Copyrights and patents. Royalties from copyrights on literary, musical, or artistic works, and similar property, or from patents on inventions, are amounts paid to you for the right to use your work over a specified period of time. Royalties are generally based on the number of units sold, such as the number of books, tickets to a performance, or machines sold.

You can recover your cost or other basis through depreciation deductions over the life of the copyright or patent. If a patent or copyright becomes worthless in any year before it expires, you can deduct your unrecovered cost or other basis in the year it becomes worthless.

Oil, gas, and minerals. Royalty income from oil, gas, and mineral properties is the amount you receive upon the extraction of natural resources from your property. The royalties are based on units, such as barrels, tons, etc., and are paid to you by a person or company who leases the property from you.

Depletion. If you are the owner of an economic interest in mineral deposits or oil and gas wells, you can recover your investment through the depletion allowance. For information on this subject, get Publication 535, *Business Expenses.*

Coal and iron ore. Under certain circumstances, you can treat amounts you receive from the disposal of coal and iron ore as payments from the sale of a capital asset, rather than as royalty income. For information about gain or loss from the sale of coal and iron ore, get Publication 544, *Sales and Other Dispositions of Assets.*

Interest in the property sold. If you sell your complete interest in the oil, gas, or mineral rights, the amount you receive is considered payment for the sale of your property, not royalty income. Under certain circumstances, the sale is subject to capital gain or loss treatment on Schedule D (Form 1040). For information on capital gain or loss, see Chapter 16.

Also, you can report the sale as an installment sale if you are to receive at least one payment after the tax year in which the sale took place. For more information, get Publication 537, *Installment Sales.*

Part of future production sold. If you own mineral property but sell part of the future production, you generally treat the money you receive from the buyer at the time of the sale as a loan from the buyer. Do not include it in income or take depletion based on it.

When production begins, you include all the proceeds in income, deduct all the production expenses, and deduct depletion from that amount to arrive at your taxable income from the property.

Your payments for the buyer's share of the proceeds are treated as a loan repayment. The buyer will treat the share as a return of capital that is not included in income or subject to a

depletion allowance. Any interest factor received by the buyer will be treated as ordinary income not subject to the allowance for depletion.

If you retain a royalty, an overriding royalty, or a net profit interest in a mineral property for the life of the property, you have made a lease or a sublease, and any cash you receive for the assignment is ordinary income subject to a depletion allowance.

Income Not Taxed

You generally should not report the following items on your return. Some of the items, however, are only partly excluded from income. A discussion of other totally or partly excluded items follows the list.

Accident and health insurance proceeds

"Black lung" benefits

Casualty insurance and other reimbursements (Chapter 26)

Child support payments (Chapter 20)

Damages awarded for physical injury or sickness

Employment agency fees (Chapter 30)

Federal Employees' Compensation Act payments

Government cost-of-living allowances (Chapter 6)

Interest on state or local government obligations (Chapter 8)

Meals and lodging (Chapter 6)

Members of the clergy housing allowance (Chapter 6)

Military allowances (Chapter 6)

Scholarships and fellowship grants

Social security benefits and equivalent railroad retirement benefits (Chapter 12)

Veterans' benefits (Chapter 6)

Workers' compensation

Campaign contributions are not income to a candidate unless they are diverted to his or her personal use. To be exempt from tax, the contributions must be spent for campaign purposes or kept in a fund for use in future campaigns. However, interest earned on bank deposits, dividends received on contributed securities, and net gains on sales of contributed securities are taxable and must be reported on Form 1120–POL, *U.S. Income Tax Return for Certain Political Organizations.* Excess campaign funds transferred to an office account must be included in the officeholder's income on line 22, Form 1040, in the year transferred.

Cash rebates. A cash rebate you receive from a dealer or manufacturer of an item you buy is not income.

Example. You buy a new car for $9,000 cash and receive a $400 rebate check from the manufacturer. The $400 is not income to you. Your cost is $8,600. This is your basis on which you figure gain or loss if you sell the car, and depreciation if you use it for business.

Employee achievement awards. You can exclude from income employee achievement awards you receive only if your employer can deduct them. To be deducted by your employer, and excluded by you, the awards must meet all the following requirements:

1) Be given for length of service or safety achievement.
2) Be tangible personal property.
3) Be given under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.
4) Be given as part of a meaningful presentation.
5) Be no more than the specified dollar limits.

Dollar limits. There are limits to the total awards you can exclude in one year. Awards from non-qualified plans are limited to $400, and total awards, from both qualified and non-qualified plans, are limited to $1,600. The cost to your employer is the determining factor for these limits. Amounts over the limits cannot be deducted by your employer and must be included in your income.

A qualified plan award is one you are awarded as part of an established written plan by your employer that does not discriminate in favor of highly compensated employees. An award will not be considered a qualified plan award if the average cost of all employee achievement awards given by your employer during the tax year is more than $400. In determining average cost, awards of nominal value are not taken into account.

Example. Ben Green received three employee achievement awards during 1990: a non-qualified plan award of a watch valued at $250, and two qualified plan awards of a stereo valued at $1,000 and a set of golf clubs valued at $500. Assuming that the requirements for qualified plan awards are otherwise satisfied, each award by itself would be excluded from income. However, since the total value of the awards is more than $1,600, Ben must include the excess of $150 ($1,750 − $1,600) in income.

Endowment proceeds paid in a lump sum to you at maturity are taxable only if the proceeds are more than the cost of the policy. Add any amounts that you previously received under the contract and excluded from income to the lump-sum payment to find how much of the total is a return of your cost and how much is an excess over your cost. Include any excess over your cost in income.

Endowment proceeds that you choose to receive in installments instead of a lump-sum payment at the maturity of the policy are taxed as an annuity as explained in Publication 575, *Pension and Annuity Income (Including Simplified General Rule).* For this treatment to apply, you must choose to receive the proceeds in installments before receiving any part of the lump sum, and within 60 days after the lump sum first may be paid to you.

Foster-care providers. Payments you receive from a state, political subdivision, or tax-exempt child-placement agency for providing foster care to qualified individuals in your home are not included in income. You cannot deduct the related expenses. However, you must include in income payments received for the care of more than 5 individuals age 19 and older.

A qualified foster individual is a person who:

1) Is living in a foster family home, and
2) Was placed there by:
   a) An agency of a state or one of its political subdivisions, or
   b) A tax-exempt child placement agency licensed by a state, if the individual is under age 19.

Difficulty-of-care payments are not included in income. These are additional payments made to foster-care providers of physically, mentally, or emotionally handicapped individuals by a state, political subdivision, or tax-exempt child placement agency that are designated as difficulty-of-care payments. A state must determine the additional compensation is needed. You must include in income difficulty-of-care payments received for more than:

1) 10 children under age 19, and
2) 5 individuals age 19 and older.

Maintaining space in home. If you are paid by a placement agency to maintain space in your home for foster-care individuals, or if you receive payments that you must include in income, you are in business as a foster-care provider and you are self-employed. You must include these payments in income. You can deduct expenses related to these payments.

Report the income and expenses on Schedule C and net business income on Schedule SE (Form 1040). See *Using Your Home in Your Work* in Chapter 30.

For more information on foster care, get Publication 501, *Exemptions, Standard Deduction, and Filing Information.*

Gifts and inheritances. Property you receive as a gift, bequest, or inheritance is not included in income. However, if property you receive this way later produces income such as interest, dividends, or rentals, that income is taxable to you. If property is given to a trust and the income from it is paid, credited, or distributed to you, that also is income to you. If the gift, bequest, or inheritance is the income from the property, that income is taxable to you.

Items given to you as an incentive to enter into a business transaction are not gifts. For example, items such as small appliances or dinnerware given to you by a bank as an incentive to make a deposit are interest income to you and must be reported at their fair market value.

Interest on frozen deposits. In general, you can exclude from income the amount of interest earned on a frozen deposit. A deposit is frozen if, at the end of the calendar year, you cannot withdraw any part of the deposit because:

1) The financial institution is bankrupt or insolvent, or
2) The state where the institution is located has placed limits on withdrawals because other financial institutions in the state are bankrupt or insolvent.

The amount of interest you can exclude from gross income for the year is the interest that was credited on the frozen deposit for that tax year minus the sum of:

1) The net amount withdrawn from the deposit during that year, and
2) The amount that could have been withdrawn at the end of that tax year (not reduced by any penalty for premature withdrawals of a time deposit).

In the year the interest becomes withdrawable, you must include in income the part of the interest that was excluded.

Example. For tax year 1990, Bill and Joan Smith had interest income of $1,500 credited to their account. The account is with a bank that has been insolvent since 1985. The

Smiths were not able to withdraw any money from this frozen account. They can exclude the $1,500 of interest credited to this account from their 1990 gross income.

Interest on qualified savings bonds. Beginning with your 1990 return, you can exclude from income the interest from qualified U.S. savings bonds you redeem to pay qualified higher education expenses. "Qualified expenses" are for tuition and required fees at an eligible educational institution for you, your spouse, or your dependent. A "qualified U.S. savings bond" is a Series EE savings bond issued after December 31, 1989, to an individual 24 years of age or older. For more information on this exclusion, see Chapter 8.

Living expenses paid by insurance. Do not include in income amounts you receive under an insurance policy for additional living expenses you and your family had because you lost the use of your home by fire, storm, or other casualty. The amount you exclude from income is limited to your extra living expenses that are more than the normal expenses you would have had. Extra living expenses, for this purpose, include only those to keep you and your family at the same standard of living you had before the loss.

Sale of home. If you are 55 or older and sell your main home, you can choose to exclude from income, under certain conditions, all or part of any gain from the sale. See Chapter 17.

Transporting schoolchildren. Do not include in income a school board mileage allowance for taking children to and from school if you are not in the business of taking children to school. You cannot deduct expenses of providing this transportation.

Life Insurance Proceeds

Life insurance proceeds paid to you because of the death of the insured person are not taxable unless the policy was turned over to you for a price. This applies even if the proceeds were paid under an accident or health insurance policy or an endowment contract.

Proceeds not received in installments. If death benefits are paid to you in a lump sum or other than at regular intervals, include them in your gross income only to the extent they are more than the amount payable to you at the time of the insured person's death. If the benefit payable at death is not specified, you include the benefit payments in income to the extent they are more than the present value of the payments at the time of death.

Proceeds received in installments. If you receive life insurance proceeds in installments, you can exclude part of each installment from your income.

To determine the excluded part, you must divide the amount held by the insurance company (generally the total lump sum payable at the death of the insured person) by the number of installments to be paid. Include anything over this excluded part in income as interest. For more information, get Publication 525.

Surviving spouse. If your spouse died before October 23, 1986, and insurance proceeds are payable to you because of the death of your spouse, and you receive them in installments, you can exclude up to $1,000 a year of the interest included in the installments. This is in addition to the part of each installment that is excluded as a recovery of the lump sum payable at death. If you remarry, you can continue to take the exclusion.

If your spouse died after October 22, 1986, you cannot exclude any interest payments included in the installment payments.

See *Insurance Received in Installments* in Chapter 8.

Interest option on insurance. If an insurance company pays you only interest on proceeds from life insurance left on deposit with them, the interest you are paid is taxable.

If your spouse died before October 23, 1986, and you chose to receive only the interest from your insurance proceeds, the $1,000 interest exclusion for a surviving spouse does not apply. If you later decide to receive the proceeds from the policy in installments, you can take the interest exclusion from the time you begin to receive the installments.

Payments to beneficiaries of deceased employees (death benefit exclusion). The first $5,000 of payments made by or for an employer because of an employee's death can be excluded from the income of the beneficiaries. The payments need not be made as the result of a contract. The amount excluded for any deceased employee cannot be more than $5,000 regardless of the number of employers or the number of beneficiaries.

This exclusion also covers payments of the balance to the credit of a deceased employee under a stock bonus, pension, or profit-sharing plan, as long as they are received during one tax year of the beneficiary.

Example. William Smith was an officer of a corporation at the time of his death last year. The board of directors voted to pay Mr. Smith's salary to his widow for the remainder of the year for his past services. During the year the corporation made payments of $18,000 to the widow. She can exclude from her income the first $5,000 she received, but must include the remaining $13,000 on line 22, Form 1040.

Self-employed individuals. The death benefit exclusion also applies to lump-sum distributions paid on behalf of self-employed individuals, if paid under a qualified pension, profit-sharing, or stock bonus plan.

Payments not qualifying. Any amount the deceased employee (or self-employed individual) had a guaranteed right to receive had death not occurred cannot be excluded as a tax-free death benefit. If the deceased employee was receiving a retirement annuity, and the beneficiary continues to receive payments under a joint and survivor annuity option, these payments do not qualify for the death benefit exclusion. However, if the deceased employee had retired on disability and at the time of death had not reached minimum retirement age, payments to the beneficiary may qualify for the death benefit exclusion. Minimum retirement age generally is the age at which an individual can receive a pension or annuity whether or not that individual is disabled.

Death benefits paid in installments over a period of years are annuity payments. If you are the beneficiary of an employee who died while still employed, the pension or annuity you receive may qualify for the death benefit exclusion. This exclusion is limited to $5,000 and generally applies to the amount by which the present value of the annuity (explained in Publication 575), figured as of the date of the employee's death, is more than the larger of:

1) The employee's contributions to the plan, or
2) The amount the employee had a guaranteed right to receive.

If you are eligible for the exclusion, add it to the cost or unrecovered cost of the annuity in figuring, at the annuity starting date, the investment in the contract.

Treatment of annuity payments to beneficiaries of employees and the death benefit exclusion are discussed in Chapter 11.

Deceased public safety officers. If you are a surviving dependent of a public safety officer (law enforcement officer or firefighter) who died in the line of duty, do not include in income the $109,460 death benefit payable to you. This applies to payments made by the Bureau of Justice Assistance.

Welfare and Other Public Assistance Benefits

Do not include in income the benefit payments from a public welfare fund, such as payments due to blindness. Payments from a state fund for the victims of crime should not be included in the victims' incomes if they are in the nature of welfare payments. Do not deduct medical expenses that are reimbursed by such a fund.

Payments for age and residency. If a state makes payments to its citizens who meet certain age and residency tests, and the payments are not based on need, the payments are not welfare benefits. Include them in gross income on line 22, Form 1040.

Handicapped persons employed in community service activities under the Employment Opportunities for Handicapped Individuals Act do not include in income the wages, allowances, or reimbursements paid to them under the Act.

Grants under the Disaster Relief Act of 1974 to help victims of natural disasters are not included in income. Do not deduct casualty losses or medical expenses that are specifically reimbursed by these disaster relief grants. Disaster unemployment assistance payments under the Act are unemployment benefits that are taxable. See *Unemployment compensation* in Chapter 6.

Mortgage assistance payments under section 235 of the National Housing Act are not included in the homeowner's gross income.

Interest paid for the homeowner under the mortgage assistance program cannot be deducted.

Payments to reduce cost of winter energy. Payments made by a state to qualified people to reduce their cost of winter energy use are not taxable.

Other Sickness and Injury Benefits

In addition to welfare or insurance benefits, you may receive other payments for sickness and injury.

Workers' compensation received by you or your beneficiaries for an occupational sickness or injury is fully exempt from tax if paid under a workers' compensation act or a statute in the nature of a workers' compensation act. The exemption also applies to your survivor(s) if the payments otherwise qualify as workers' compensation. The exemption from tax, however, does not apply to retirement benefits you receive based on your age, length of service, or prior contributions to the plan, even though

you retired because of occupational sickness or injury.

If part of your workers' compensation reduces your social security or equivalent railroad retirement benefits received, you may have to include part of the workers' compensation in income. For more information, see Publication 915, *Social Security Benefits and Equivalent Railroad Retirement Benefits.*

If you return to work after qualifying for workers' compensation, payments you continue to receive while assigned to light duties are taxable.

Federal Employees' Compensation Act (FECA) payments for personal injury or sickness, including payments to beneficiaries in case of death, are not taxable. However, amounts are taxable that are received under this Act as "continuation of pay" for up to 45 days while a claim is being decided. Also, pay for sick leave while a claim is being processed is taxable and must be included in income as wages.

You can deduct the amount you spend to "buy back" sick leave for an earlier year to be eligible for nontaxable FECA benefits for that period. It is a miscellaneous deduction subject to the 2% limit on Schedule A (Form 1040). If you "buy back" sick leave in the same year you use it, the amount reduces your taxable sick leave pay. Do not deduct it separately.

Other compensation. Many other amounts you receive as compensation for injury or illness are not taxable. These include:

Compensatory damages received for injury or illness (however, punitive damages in cases not involving physical injury or sickness are taxable),

Benefits received under an accident or health insurance policy attributable to premiums you paid,

Disability benefits received for loss of income or earning capacity as a result of injuries under a "no-fault" automobile policy, and

Compensation received for permanent loss or loss of use of a part or function of your body, or for your permanent disfigurement. This compensation must be figured only on the injury and not on the period of your absence from work. These benefits are exempt from tax even though your employer pays for the accident and health plan that provides these benefits.

Reimbursement for medical care is generally not taxable. However, this reimbursement may reduce your medical expense deduction. For more information, see Chapter 22.

Scholarships and Fellowship Grants

If you receive a scholarship or fellowship grant, you may be able to exclude from income all or part of the amounts you receive.

Qualified scholarships. Only a candidate for a degree can exclude amounts received as a qualified scholarship. A qualified scholarship is any amount you receive that is for:

1) Tuition and fees to enroll at or attend an educational organization, or
2) Fees, books, supplies, and equipment required for courses at the educational institution.

Amounts used for room and board do not qualify.

All payments you receive for services must be included in income, even if the services are a condition of receiving the grant and are required of all candidates for the degree. This includes amounts received for teaching and research. Get Publication 520, *Scholarships and Fellowship Grants,* for information on how to report the taxable portion of scholarships and fellowship grants.

Educational assistance allowances paid by the Department of Veterans Affairs are not included in gross income. These allowances are not considered scholarships or fellowship grants.

Scholarship prizes won in a contest are not scholarships or fellowships if you do not have to use the prizes for educational purposes. You must include these amounts in your gross income on line 22, Form 1040, whether or not you use the amounts for educational purposes.

Qualified tuition reductions are excluded from income. A ***qualified tuition reduction*** is the amount of reduction in tuition for education (below the graduate level) furnished to an employee of an educational institution (or certain other persons) provided certain requirements are met. However, graduate students who engage in teaching or research activities for the educational institution may qualify for this exclusion. For more information, get Publication 520.

14. Tax Shelters

Investments that yield tax benefits are sometimes called "tax shelters." In some cases, Congress has concluded that the loss of revenue is an acceptable side effect of special tax provisions designed to encourage taxpayers to make certain types of investments. In many cases, however, losses from tax shelters produce little or no benefit to society or the tax benefits are exaggerated beyond those intended. Those cases are referred to as "abusive tax shelters."

An investment that is considered a tax shelter is subject to restrictions, including the requirement that it be registered, as discussed later in *Curbing abusive tax shelters,* unless it is a projected income investment.

Passive activity losses and credits. The passive activity loss and credit rules limit the amount of losses and credits that can be claimed from such activities and limit the amount that can offset nonpassive income, such as certain portfolio income from investments. For more detailed information about determining and reporting income, losses, and credits from passive activities, see Publication 925, *Passive Activity and At-Risk Rules.*

Projected Income Investment

Special rules apply to a tax shelter that is not expected to reduce the tax liability of any investor. That tax shelter is considered to be a projected income investment. To qualify as a projected income investment, the tax shelter must not be expected to reduce the ***cumulative tax liability*** of any investor during any year of the first 5 years ending after the date the investment was offered for sale.

For more information about projected income investments, see the discussion under *Tax Shelters* in Publication 550, *Investment Income and Expenses.*

Abusive Tax Shelters

Abusive tax shelters are marketing schemes that involve artificial transactions with little or no economic reality. They often make use of unrealistic allocations, inflated appraisals, losses in connection with nonrecourse loans, mismatching of income and deductions, financing techniques that do not conform to standard commercial business practices, or the mischaracterization of the substance of the transaction. Despite appearances to the contrary, the taxpayer generally risks little.

Abusive tax shelters commonly involve package deals that are designed from the start to generate losses, deductions, or credits far in excess of present or future investment, or that promise investors from the start that future inflated appraisals will enable them, for example, to reap charitable contribution deductions based on those appraisals. (But see the appraisal requirements discussed under *Curbing abusive tax shelters.*) They are commonly marketed in terms of the ratio of tax deductions allegedly available to each dollar invested. This ratio (or "write-off") is frequently said to be several times greater than one-to-one.

Since there are many abusive tax shelters, it is not possible to list all the factors you should consider in determining whether an offering is an abusive tax shelter. However, you should ask the following questions, which might provide a clue to the abusive nature of the plan.

- Do the tax benefits far outweigh the economic benefits?
- Is this a transaction you would seriously consider, apart from the tax benefits, if you hoped to make a profit?
- Do shelter assets really exist and, if so, are they insured for less than their purchase price?
- Is there a nontax justification for the way profits and losses are allocated to partners?
- Do the facts and supporting documents make economic sense? In that connection, are there sales and resales of the tax shelter property at ever increasing prices?
- Does the investment plan involve a gimmick, device, or sham to hide the economic reality of the transaction?
- Does the promoter offer to backdate documents after the close of the year and are you instructed to backdate checks covering your investment?
- Is your debt a real debt or are you assured by the promoter that you will never have to pay it?
- Does this transaction involve laundering United States source income through foreign corporations incorporated in a tax haven and owned by United States shareholders?

Curbing abusive tax shelters. Congress has enacted a series of income tax laws designed to halt the growth of abusive tax shelters. These include:

1) ***Registration of tax shelters.*** Generally, the organizers of certain tax shelters must register the shelter with the Internal Revenue Service (IRS). The IRS will then assign the tax shelter a registration number. See *Investor Reporting*, later, for more information about reporting this number when filing your tax return.

2) ***List of investors.*** Organizers and sellers of any potentially abusive tax shelter must maintain a list identifying each investor. (This rule, however, does not apply to an investor who, as a seller, later transfers an interest in a tax shelter that is a projected income investment.) The list must be available for inspection by the IRS and the information required to be included on the list generally must be retained for 7 years. See *Transfer of interests in a tax shelter*, later, for additional information.

3) ***Appraisals of donated property.*** Generally, if the value of property you donate exceeds $5,000 ($10,000 in the case of privately traded stock), you must get a written "qualified" appraisal of the property's fair market value and attach an appraisal summary to your income tax return. For more information, see Publication 561, *Determining the Value of Donated Property.*

4) ***Interest on penalties.*** If you are assessed an accuracy-related or fraud penalty, interest will be imposed on the amount of the penalty from the due date of the return (including any extensions) to the date of payment of the penalty.

5) ***Accounting methods and capitalization rules.*** Tax shelters generally may not use the cash method of accounting. Also, uniform capitalization rules generally apply to the production or purchase of inventory goods, to constructed business property, and to noninventory property produced or purchased for sale. For more information, see Publication 538, *Accounting Periods and Methods.*

Investor Reporting

If you include on your tax return any deduction, loss, credit or other tax benefit, or any income, from an interest in a tax shelter required to be registered, you must report the registration number the tax shelter provided to you. (See *Registration of tax shelters*, earlier.) Complete and attach **Form 8271,** *Investor Reporting of Tax Shelter Registration Number,* to your return to report the number and to provide other information about the tax shelter and its benefits. You must also attach Form 8271 to any application for tentative refund (Form 1045) and to any amended return (Form 1040X) on which such benefits are claimed or income is reported. If you do not include the registration number with your return, you will be subject to a penalty of $250 for each such failure, unless the failure is due to reasonable cause.

Exception. Even if you have an interest in a registration-required tax shelter, you do not have to file Form 8271 if you did not claim any deduction, loss, credit or other tax benefit, or report any income from that tax shelter.

Transfer of interests in a tax shelter. If you hold an investment interest in a tax shelter and later transfer that interest to another person, you must either maintain a list identifying each person to whom you transferred your interest or require a designated person or seller to maintain the list. If you choose to delegate this requirement, you must submit to the designated person or seller all of the information that you would otherwise be required to maintain on the list.

If the tax shelter is not a projected income investment, described earlier, you must provide its registration number as well as a notification to each person to whom you transferred your interest in that tax shelter.

If you do not maintain the required list of investors, or do not delegate a designated person or seller to maintain the list, you will be subject to a penalty.

Under certain circumstances, maintaining an identification list is not required for transfers of an interest in a projected income investment. See *Investor Reporting* in Publication 550 for more information about this notification.

Penalties. If your return is examined by the IRS and a tax deficiency is determined, you will be faced with payment of additional tax, interest on the underpayment, and possibly one or more penalties. Most of these penalties are explained under *Penalties* in Chapter 1. Other additional costs that an abusive tax shelter may generate are explained in the *Tax Shelters* discussion of Publication 550.

Abusive tax shelter detection program. The IRS has implemented a program to detect and identify those returns, claims, or applications for refund, in which benefits from abusive tax shelter promotions are claimed. Under this program, the IRS will detect and identify such returns, claims, and applications before processing and before refunds are paid. When appropriate, the IRS will reduce refunds that are specifically attributable to the abusive tax shelter.

Loss carryback adjustments. Under the detection program, the IRS also may offset an assessed deficiency against a scheduled refund resulting from a decrease in tax based on the carryback of a net operating loss. (Form 1045, *Application for Tentative Refund,* is used to apply for a quick refund of taxes from such carrybacks.) See *Abusive Tax Shelter Detection Program* in Publication 550 for more information about the Service's determination of such adjustments.

Pre-filing notification letter. If you are an investor in an abusive tax shelter promotion, the IRS may send you a "pre-filing notification letter," if it determines that it is highly likely that there is:

1) A gross valuation overstatement, or

2) A false or fraudulent statement regarding the tax benefits to be derived from the tax shelter entity or arrangement.

If you claim the benefits after receiving the pre-filing notification or if you fail to amend your return, you will be notified that your tax return is being examined. For information on the examination of returns, see *The Examination and Appeals Process* near the end of this publication.

Revenue rulings. The IRS has published numerous revenue rulings concluding that the claimed tax benefits of various abusive tax shelters should be disallowed. A revenue ruling is the conclusion of the IRS on how the law is applied to a particular set of facts. Revenue rulings are published in the *Internal Revenue Bulletin* for taxpayers' guidance and information and also for use by IRS officials. So, if your return is examined and an abusive tax shelter is identified and challenged, a published revenue ruling dealing with that type of shelter, which disallows certain claimed tax shelter benefits, would serve as the basis for the examining official's challenge of the tax benefits that you claimed. In such a case, the examiner will not compromise even if you or your representative believe that you have authority for the positions taken on your tax return.

New financial products. The IRS's Office of Chief Counsel has an organization devoted to identifying and analyzing new financial products that are being created and sold to investors in public offerings. This organization provides guidance about the tax consequences of transactions through the issuance of revenue rulings and regulations.

The IRS encourages taxpayers and tax practitioners to submit prospectuses and/or other written descriptions of current investment transactions to the Office of Chief Counsel at the following address:

Assistant Chief Counsel
(Financial Institutions and Products)
Room 4300
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Whether to invest. In light of the adverse tax consequences and the substantial amount of penalties and interest that may result if the claimed tax benefits are disallowed, you should consider tax shelter investments carefully, and seek competent legal and financial advice.

Part III
Gains and Losses

A gain from selling stocks, bonds, or other investment property may be taxed or it may be tax free, at least in part. A loss may or may not be deductible. The chapters in this part discuss these investment gains and losses. They also discuss gains from selling property you personally use—including the special rules for selling your home. Nonbusiness casualty and theft losses are discussed in Chapter 26 of Part V.

15. Basis of Property

Basis is a way of measuring your investment in property for tax purposes. Use the basis of property to figure the deductions for depreciation, amortization, depletion, and casualty losses. Also use it to figure gain or loss on the sale or other disposition of property. You must keep accurate records of all items that affect the basis of property so you can make these computations.

This chapter is divided into three sections: Cost Basis, Adjusted Basis, and Other Basis.

The basis of property you buy is usually its cost to you. Your original basis in property (whether cost or other) must be increased or decreased (adjusted) for certain events. If you make improvements to the property, this will increase your basis. If you take deductions for depreciation or casualty losses, this will reduce your basis.

Your basis in some assets cannot be determined by cost. This includes property you receive as a gift or inheritance. It also applies to property received in an involuntary exchange and certain other circumstances.

This chapter does not reflect the provisions of the law that deal with bankruptcy. If any of your debts were canceled by a creditor, or were discharged because you became bankrupt, the basis of your assets might be affected. For information about the effect these provisions may have on basis, see Publication 908, *Bankruptcy and Other Debt Cancellation*.

Cost Basis

The basis of property you buy is usually its cost. The cost is the amount of cash you pay for it and the fair market value of other property or services you provide in the transaction. Your cost also includes amounts you pay for:

1) Sales tax charged on the purchase,
2) Freight charges to obtain the property, and
3) Installation and testing charges.

In addition, the cost basis of real estate and business assets will include other items.

Loans with low or no interest. If you buy property on any time-payment plan that charges little or no interest, the basis of your property is your stated purchase price, less the amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than 9% compounded semi-annually.

For more information, see *Unstated Interest* in Publication 537, *Installment Sales*.

Real Property

If you buy real property, certain fees and other expenses you pay are part of your basis in the property.

Assumption of a mortgage. If you buy property and become liable for an existing mortgage on the property, your basis is the amount you pay for the property in cash plus the unpaid mortgage you assume.

Settlement fees and other costs. Legal and recording fees are some of the settlement fees or closing costs that are included in the basis of property. Some others are:

1) Abstract fees,
2) Charges for installing utility services,
3) Surveys,
4) Transfer taxes,
5) Title insurance, and
6) Any amounts the seller owes that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

You must reasonably allocate these fees or costs between land and improvements to figure the basis for depreciation of the improvements. Settlement fees do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

Real estate taxes. If you buy real property and agree to pay taxes the seller owed on it, the taxes you pay are treated as part of the cost. You cannot deduct them as taxes paid. If you reimburse the seller for taxes the seller paid for you, you can usually deduct that amount. Do not include that amount in the cost of the property.

Adjusted Basis

Before you can figure any gain or loss on a sale, exchange, or other disposition of property, or figure allowable depreciation, depletion, or amortization, you usually must make certain adjustments (increases and decreases) to the basis of the property. The result of these adjustments to the basis is the adjusted basis.

Increases to Basis

The basis of any property is increased by all items properly added to a capital account. This includes the cost of any improvements having a useful life of more than one year and amounts spent after a casualty to restore the damaged property. Other items added to the basis of property include the cost of extending utility service lines to the property, and legal fees, such as the cost of defending and perfecting title.

Improvements. The cost of improvements that add to the value of property, lengthen its life, or adapt it to a different use is added to your basis in the property. For example, putting a recreation room in your unfinished basement, adding another bathroom or bedroom, putting up a fence, putting in new plumbing or wiring, installing a new roof, or paving your driveway are improvements, and their costs are added to your basis in your home.

Assessments for local improvements. Assessments for improvements such as streets and sidewalks, which tend to increase the value of the property assessed, must be added to the basis of the property and not deducted as taxes. For example, if your city puts in a paved sidewalk along the street running in front of your home, and assesses you and the other affected landowners for the cost of the sidewalk, you must add the assessment to the basis of your property. However, assessments for maintenance or repair or meeting interest charges on the improvements are deductible as taxes.

Decreases to Basis

You must decrease the basis of your property by any items that represent a return of capital, such as the receipt of nontaxable dividends.

Casualties and thefts. If you have a casualty or theft loss, you must decrease the basis of your property by the amount of any insurance or other reimbursement you receive and by any deductible loss not covered by insurance. However, increase your basis for amounts you spend after a casualty to restore the damaged property. For more information, see Chapter 26.

Easements. The amount you receive for granting an easement is usually considered to be from the sale of an interest in your real property. It reduces the basis of the affected part of the property. If the amount received is more than the basis of the part of the property affected by the easement, your basis is reduced to zero and the excess is a recognized gain.

Residential energy credit. The residential energy credit is no longer available. However, if you were allowed the credit, you must decrease the basis of your home by the amount of the credit if you added the cost of the energy items to the basis of your home.

Section 179 deduction. If you elect to take the section 179 deduction for any part of the cost of property, you must decrease the basis of the property by the amount of the section 179 deduction.

Depreciation. You must decrease the basis of your property by the amount of depreciation that you could have deducted on your tax returns under the method of depreciation you selected. If you deducted more depreciation than you should have, you must decrease your basis by the amount you should have deducted, plus the part of the excess deducted that resulted in a decrease in your tax liability for any year. However, if you deducted less depreciation than you could have, decrease your basis by the amount that you could have deducted. Usually, you figure the amount of depreciation you could have deducted by using

the accelerated cost recovery system (ACRS) or the modified accelerated cost recovery system (MACRS) for recovery property and the straight line method for other property.

Adjusted Basis Example

You owned a duplex used as rental property that cost you $40,000. The $40,000 cost was allocated $35,000 for the building and $5,000 for the land. You added an improvement to the duplex that cost $10,000. On February 1, 1989, the duplex was damaged by fire. Up to that time you had been allowed depreciation of $23,000. You sold the salvage for $1,300 and collected $19,700 from your insurance company. You deducted a casualty loss of $1,000 on your 1989 income tax return. You spent $19,000 of the insurance proceeds for restoration of the duplex, which was completed in 1990. The adjusted basis of the duplex, after the restoration, is figured as follows:

Original cost of duplex		$35,000
Addition to duplex		10,000
Total cost of duplex		$45,000
Minus: Depreciation		23,000
Adjusted basis before casualty		$22,000
Minus: Casualty loss	$ 1,000	
Insurance proceeds	19,700	
Salvage proceeds	1,300	22,000
Adjusted basis after casualty		$ -0-
Add: Cost of restoring duplex		19,000
Adjusted basis after restoration		$19,000

Your basis in the land is its original cost of $5,000.

Other Basis

There are many times when you cannot use cost as a basis. In these cases the fair market value or the adjusted basis of certain property may be important.

Fair market value. Fair market value is the price at which the property would change hands between a buyer and a seller, neither being required to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property, on or about the same date, may be helpful in figuring the fair market value of the property.

Property received for services. If you receive property for your services, you must include the property's fair market value in income. The amount you include in income becomes your basis.

Restricted property. If you receive property for your services and the property is subject to certain restrictions, your basis in the property is its fair market value when you can transfer it or when it is not subject to a substantial risk of forfeiture. For more information, see *Restricted Property Received for Services*, in Publication 525, *Taxable and Nontaxable Income*.

Bargain purchases. If your employer lets you purchase goods or other property at less than fair market value, you must include the difference between the purchase price and the fair market value of the property in your income. However, if this difference represents a qualified employee discount, you do not include the difference in income. See *Qualified Employee Discount* in Chapter 6. Your basis in the property is its fair market value, that is, your purchase price plus the amount (if any) you include in your income.

Taxable exchanges. A taxable exchange is one in which the gain is taxable or the loss is deductible. If you receive property in exchange for other property in a taxable exchange, the basis of the property you receive is usually its fair market value at the time of the exchange.

Involuntary Exchanges

If you acquire property as a result of an involuntary exchange, such as a casualty, theft, or condemnation, the basis of the replacement property you acquire may be figured using the basis of the property exchanged.

Similar or related property. If you receive property that is similar or related in service or use to the property exchanged, the basis of the new property is the same as the basis of the old property, decreased by any loss recognized on the exchange and money received that was not spent on similar property and increased by any gain recognized on the exchange and any added cost of getting the new property.

Not similar or related property. If you receive money or other property that is not similar or related in service or use to the old property, and you buy new property that is similar or related in service or use to the old property, the basis of the new property is the cost of the new property, decreased by the amount of gain that is not recognized on the exchange.

Example. Your property was condemned by the state. The property had an adjusted basis of $26,000, and the state paid you $31,000 for it. You realized a gain of $5,000 ($31,000 – $26,000). You bought new property that is similar in use to the old property for $29,000, and you recognize a gain of $2,000 ($31,000 – $29,000), the unspent part of the payment from the state. The basis of the new property is figured as follows:

Cost of new property	$29,000
Minus: Gain not recognized	3,000
Basis of new property	$26,000

Allocating the basis. You must allocate the basis among the parts of the new property you acquire as a result of an involuntary exchange. This allocation usually is based on the ratios of the fair market value of each part of the new property to the total fair market value of the whole new property.

If you buy more than one piece of replacement property, allocate your basis among the properties based on their respective costs. If, in the previous example, the state had condemned unimproved real property, and the new property you bought was improved real property with both land and buildings, you would allocate the basis of the new property, $26,000, between land and buildings based on their fair market values.

Nontaxable Exchanges

A nontaxable exchange is an exchange in which any gain is not taxed and any loss cannot be deducted. In a nontaxable exchange, business or investment property is exchanged solely for like property, stock is exchanged solely for stock of the same corporation, or property is exchanged for securities of a controlled corporation.

Partially nontaxable exchange. A partially nontaxable exchange is an exchange in which you receive unlike property or money in addition to like property.

Basis of property. The basis of property you receive in a nontaxable or partially nontaxable exchange is usually the same as the basis of the property exchanged ***decreased*** by any money you received and any loss recognized on the exchange; and then ***increased*** by any additional costs incurred, and any gain recognized on the exchange. See *Nontaxable Trades* in Chapter 16.

The basis must be allocated among the properties, other than money, that you received in the exchange. In making this allocation, the basis of the unlike property is its fair market value on the date of exchange. The remainder is the basis of the like property.

Example. You trade in an old truck, that has an adjusted basis of $1,700, for a new one costing $6,800. The dealer allows you $2,000 on the old truck and you pay $4,800 in cash. This is a nontaxable exchange and the basis of the new truck is $6,500, that is, the adjusted basis of the old one, $1,700, increased by the additional cost, $4,800. If you sell your old truck to a third party for $2,000 and then buy the new one from the dealer, you have a taxable gain on the sale, and the basis of the new truck is the price you pay the dealer for it.

Trade-in or sale and purchase. You cannot increase the basis of property for depreciation by selling your old property outright to a dealer and then buying the new property from the same dealer, if the sale and purchase are actually a single transaction. If the sale to the dealer of your old property and your purchase from that dealer of the new property are dependent on each other, you are considered to have traded in your old property. The transaction is treated as an exchange no matter how it is carried out.

Example. You are a salesperson and use one of your cars 100% for business. You have used this car in your sales activities for 2 years and have depreciated it. Your adjusted basis in the car is $2,600, and its market value is $3,100.

You are interested in a new car with a listed retail price of $8,695, which usually sells for $8,000. If you trade your old car for the new one and pay the dealer $4,900, your basis for depreciation for the new car would be $7,500 ($4,900 cash plus $2,600 basis of your old car). However, you want a higher basis for depreciating the new car, so you agree to pay the dealer $8,000 cash for the new car if he will pay you $3,100 for your old car.

Since the sale and purchase are dependent on each other, you are treated as if you had exchanged your old car for the new one. Your basis for depreciating the new car is $7,500, which is the same as it would be if you had traded the old car.

For information about the trade of a car used partly for business, see Publication 917, *Business Use of a Car*.

Property Received as a Gift

To figure the basis of property you receive as a gift, you must know its adjusted basis to the donor just before it was given to you, its fair market value (FMV) at the time it was given to you and the amount of gift tax paid on it.

FMV less than donor's adjusted basis. If the FMV of the property was less than the donor's adjusted basis, your basis for depreciation, depletion, and amortization, and for gain on its sale or other disposition is the same as the donor's adjusted basis. Your basis for loss

on its sale or other disposition is its FMV at the time you received the gift.

FMV more than donor's adjusted basis. If the FMV of the property was equal to or greater than the donor's adjusted basis, your basis is the same as the donor's adjusted basis at the time you received the gift. Your basis is increased by all or part of the gift tax paid, depending on the date of the gift.

Gift received before 1977. If you received a gift before 1977, your basis in the gift (the donor's adjusted basis) is increased by the total gift tax paid on it, but not above the FMV of the gift when it was given to you.

Example 1. You were given a house in 1976. At that time it had a FMV of $21,000, and the donor's adjusted basis was $20,000. The donor paid a gift tax of $500. Your basis for gain or loss and for depreciation is $20,500, the donor's adjusted basis plus the gift tax paid.

Example 2. If, in Example 1, the gift tax paid had been $1,500, your basis would be $21,000. This is the donor's adjusted basis plus the gift tax paid, limited to the FMV of the house at the time you received the gift.

Gift received after 1976. If you received a gift after 1976, your basis in the gift (the donor's adjusted basis) is increased by the part of the gift tax paid that is due to the net increase in value of the gift. This part is figured by multiplying the gift tax paid on the gift by a fraction. The numerator (top part) of the fraction is the net increase in value of the gift, and the denominator (bottom part) is the amount of the gift. The net increase in value of the gift is the FMV of the gift minus the donor's adjusted basis.

Example. In 1990 you received a gift of property from your mother. At that time the property had a FMV of $50,000 and her adjusted basis was $20,000. She paid a gift tax of $9,000 on the property. For figuring depreciation, depletion, amortization, and gain or loss, your basis is $25,400, figured as follows:

Fair market value	$50,000
Minus: Adjusted basis	20,000
Net increase in value	$30,000
Gift tax paid	$ 9,000
Multiplied by ($30,000 ÷ $50,000)	.60
Gift tax due to net increase in value	$ 5,400
Adjusted basis of property to your mother	20,000
Your basis in the property	$25,400

Property Transferred From a Spouse

The basis of property transferred to you or transferred in trust for your benefit by your spouse, or by your former spouse if the transfer is incident to divorce, is the same as the transferor's adjusted basis of the property. However, your basis is adjusted for any gain recognized by the transferor on a transfer of property in trust in which the sum of the liabilities assumed, plus the liabilities to which the property is subject, is more than the adjusted basis of the property transferred.

If the property transferred is a Series E or EE United States savings bond, the transferor must include in income the interest accrued to the date of transfer. The transferee's basis in the bond immediately after the transfer is equal to the transferor's adjusted basis in the bond increased by the interest income includible in the transferor's income.

The transferor must supply you with records necessary to determine the adjusted basis and holding period of the property as of the date of the transfer. For more information regarding the transfer of property between spouses, see Chapter 16.

Inherited Property

Your basis in property you inherit is usually its fair market value (FMV) at the date of the decedent's death. If a federal estate tax return has to be filed, your basis in property you inherit can be its FMV at the alternate valuation date if the estate qualifies and elects to use alternate valuation. If a federal estate tax return does not have to be filed, your basis in the property is its appraised value at the date of death for state inheritance or transmission taxes.

Your basis in inherited property may also be figured under the special farm or closely held business real property valuation method, if chosen for estate tax purposes. See Publication 448, *Federal Estate and Gift Taxes*, for information on valuation methods for estate tax purposes.

For more information about the basis of inherited property, such as property held by a surviving tenant and qualified joint interest in property held by a husband and wife, see *Inherited Property* in Publication 551, *Basis of Assets*.

Property Changed to Business or Rental Use

When you hold property for personal use and change it to business use or use it to produce rent, such as renting out your former home, you must figure the basis for depreciation.

Basis for depreciation. The basis for depreciation equals the lesser of:

1) The FMV of the property on the date of the change, or
2) Your adjusted basis on the date of the change—that is, your original cost or other basis of the property, plus the cost of permanent improvements or additions since you acquired it, minus deductions for any casualty losses claimed on earlier years' income tax returns and other decreases to basis.

Example. Several years ago you built your home for $60,000 on a lot that cost you $10,000. Before changing the property to rental use last year, you added $20,000 of permanent improvements to the house and claimed a $2,000 deduction for a casualty loss to the house. Because land is not depreciable, you can only include the cost of the house when figuring the basis for depreciation.

Your adjusted basis in the house at the time of the change in use is $78,000 ($60,000 + $20,000 − $2,000). On the date of the change in use, your property has a FMV of $80,000, of which $15,000 is for the land and $65,000 is for the house. The basis for depreciation on the house is the FMV at the date of the change ($65,000) because it is less than your adjusted basis ($78,000).

Sale of property. If you later sell or dispose of the property, the basis of the property to be used will depend on whether you are figuring gain or loss.

Gain. The basis for gain is your adjusted basis when you sell the property—that is, your original cost or other basis, plus the cost of any permanent improvements or additions, less depreciation allowed or allowable, deductions for casualty losses claimed on prior years' returns, and other decreases to basis, such as amounts received for easements or rights-of-way.

Loss. The basis for loss is figured using the smaller of your adjusted basis or the FMV of the property at the time of the change to business or rental use. Increase this amount by the cost of improvements and additions you made after the change, and reduce it by your depreciation and casualty loss deductions you claimed after the change.

Example. You sell your house, which you had changed to rental property after using it as your home. You originally bought the house for $35,000. When you changed it to rental use, it had a FMV of $33,000. You claimed $3,000 depreciation, figured under the straight line method, while renting it, so your adjusted basis at the time of the sale, for figuring gain, is $32,000, and for figuring loss is $30,000. If the sales price is between $30,000 and $32,000, you have neither a gain nor a loss on the sale.

Stocks and Bonds

The cost basis of stocks or bonds is the purchase price plus the costs of purchase such as commissions and recording or transfer fees. If you acquired stocks or bonds other than by purchase, your basis is usually determined by fair market value or the donor's adjusted basis, as previously discussed.

The basis must be adjusted for certain events that occur after purchase. For example, if you receive additional stock from nontaxable stock dividends or stock splits, you must reduce the basis of your original stock. You must also reduce your basis when you receive nontaxable distributions because these are a return of capital.

Example. In 1988, you bought 100 shares of XYZ stock for $1,000 or $10 a share. In 1989, you bought 100 shares of XYZ stock for $1,600 or $16 a share. In 1990, XYZ declared a 2-for-1 stock split. You now have 200 shares of stock with a basis of $5 a share and 200 shares with a basis of $8 a share.

Other basis. There are other ways to determine the basis of stocks or bonds depending on how you acquired them. Some ways in which you can acquire stock are by automatic investment programs, dividend reinvestment plans, and stock rights. For detailed information, see Publication 550, *Investment Income and Expenses*.

Identifying shares. If you buy and sell securities at different times in varying quantities and you cannot definitely identify the securities you sell, the basis of those sold is figured under the first-in first-out method—that is, the first securities you acquired are the first sold.

Identification. You make an adequate identification if you deliver to your broker or agent certificates for securities that you purchased on a certain date or for a specific price.

If you left the security certificates with your broker or other agent, an adequate identification is made if you:

1) Tell your broker the particular security to be sold or transferred at the time of the sale or transfer, and
2) Receive a written confirmation of this from your broker or other agent within a reasonable time.

If you bought securities in different lots at different times and you hold a single certificate for these securities, you make an adequate identification if you:

1) Tell your broker the particular security to be sold or transferred when you deliver the certificate to your broker, and
2) Receive a written confirmation of this from your broker or other agent within a reasonable time.

Mutual fund shares. You may choose to use the average basis of shares you own in a regulated investment company if you acquired the shares at different times and prices, and if you left the shares on deposit in an account kept by a custodian or agent. For more information, see Publication 564, *Mutual Fund Distributions.*

Premiums on bonds. If you buy a taxable bond at a premium, and choose to amortize the premium paid, you must reduce the basis of the bond by the amount of the amortized premium. See *Bond Premium* in Chapter 10 of Publication 535, *Business Expenses,* for information about the deductibility of the amount amortized. Although you cannot take a deduction for the premium on tax-exempt bonds, you must amortize the premium and decrease your basis in the bonds by the amount of the amortizable bond premium.

Original issue discount (OID) on debt instruments. You must increase your basis in an OID debt instrument by the amount of OID that you included in income for that instrument. See *Original Issue Discount* in Chapter 8.

Tax-exempt bonds. OID on tax-exempt bonds is not taxable. However, there are special rules for determining basis on tax-exempt original issue discount bonds issued after September 3, 1982, and acquired after March 1, 1984. See Publication 550.

16. Sale of Property

Important Reminder

Holding period. The holding period for a long-term gain or loss is more than one year, and the holding period for a short-term gain or loss is one year or less.

This chapter explains how you figure your gain or loss when you sell or trade investment property. To determine whether you had a gain or loss on a sale of property, you generally subtract your adjusted basis from the amount you realize. This chapter includes information about the difference between a sale and a trade, nontaxable trades, and capital and noncapital assets.

Certain sales or trades of property are discussed in other IRS publications. They include, for example, installment sales, covered in Publication 537, *Installment Sales,* and transfers of property at death, covered in Publication 559, *Tax Information for Survivors, Executors, and Administrators.*

Publication 544, *Sales and Other Dispositions of Assets,* provides information about various types of transactions involving business property, including dispositions of assets used in a trade or business or for the production of income.

Publication 550, *Investment Income and Expenses,* provides more detailed discussion about sales and trades of investment property. Publication 550 includes information about the rules covering bad debts, straddles, section 1256 contracts, puts and calls, commodity futures, short sales and wash sales. It also discusses investment-related expenses.

Publication 925, *Passive Activity and At-Risk Rules,* discusses the rules that limit losses and credits from passive activities as well as the rules that apply on the disposition of an interest in a passive activity.

For information about the tax treatment of selling your home, see Chapter 17.

Form 1099–B. If you sold property such as securities, commodities, bonds, etc., through a broker, you should receive Form 1099–B, *Statement for Recipients of Proceeds From Broker and Barter Exchange Transactions,* or an equivalent statement from the broker. You should receive the statement by January 31, 1991, showing the gross proceeds from sales during 1990. The Internal Revenue Service (IRS) will also get a copy of Form 1099–B from the broker.

If you receive a Form 1099–B or equivalent statement, you must complete Schedule D of Form 1040.

Unstated interest and imputed principal rules for sales or exchanges. For information about the unstated interest rules applicable to certain payments received on account of a *seller-financed* sale or exchange of property, and about the imputed principal rules applicable to any debt instrument issued on account of such transactions, see Publication 537.

Sales and Trades

Sales and trades (or exchanges) of assets generally result in taxable gains or deductible losses, although some trades of property are nontaxable.

What is a Sale or Trade?

A sale is generally a transfer of property for money only or for a promise to pay money, such as a mortgage or note. A trade is a transfer of property in return for other property or services, and may be taxed in the same way as a sale.

Sale and purchase. Ordinarily, a transaction is not a trade when you voluntarily sell property for cash and immediately buy similar property to replace it. Such a sale and purchase are two separate transactions.

A redemption of stock is treated as a sale or trade and is subject to the capital gain or loss provisions unless the redemption is a dividend or other distribution on stock.

Dividend vs. sale or trade. Whether a redemption is treated as a sale, trade, dividend, or other distribution depends on the circumstances in each case. Both direct and indirect ownership of stock will be considered. The redemption is treated as a sale or trade of stock if:

1) The redemption is not essentially equivalent to a dividend (see Chapter 9),
2) There is a substantially disproportionate redemption of stock,
3) There is a complete redemption of all the stock of the corporation owned by the shareholder, or
4) The redemption is a distribution in partial liquidation of a corporation.

A redemption or retirement of bonds or notes at their maturity is a sale or trade that you must report on Schedule D (Form 1040) whether or not you realize gain or loss on the transaction.

However, if the issuer has merely extended the maturity date of its notes, during which period some of the noteholders have agreed not to redeem their notes until all the other notes are retired or their retirement is provided for, neither a trade nor a closed or completed transaction has occurred. Under these circumstances, you do not figure gain or loss.

A surrender of stock by a dominant shareholder, who retains control of the corporation, is treated as a contribution to capital rather than as an immediate loss deductible from taxable income. The surrendering shareholder must reallocate his or her basis in the surrendered shares to the shares he or she retains.

Figuring a Gain or Loss

You figure gain or loss on a sale or trade of property by comparing the amount you realize with the adjusted basis of the property.

Gain is the amount you realize from a sale or trade minus the adjusted basis of the property you transfer.

Loss is the adjusted basis of the property minus the amount you realize.

The adjusted basis of property is your original cost or other original basis property adjusted (increased or decreased) for items such as purchase commissions and legal fees. In determining gain or loss, the cost of transferring property to the new owner, such as selling expenses, is added to the adjusted basis of the property. See Chapter 15 for more information about determining the adjusted basis of property.

Amount realized. The amount you realize from a sale or trade of property is everything you receive for the property. This includes the money you receive plus the fair market value of all property or services you receive.

Fair market value is the price at which the property would change hands between a buyer and a seller, neither being forced to buy or sell and both having reasonable knowledge of all the relevant facts.

The fair market value of notes or other evidence of indebtedness you receive as a part of the sale price is usually the best amount you can get from selling them to, or discounting them with, a bank or other buyer of such debt instruments.

An indebtedness against the property, or against you, that is paid off as a part of the transaction, or that is assumed by the buyer, must be included in the amount realized. This is true even if neither you nor the buyer is personally liable for the debt. For example, if you sell or trade property that is subject to a nonrecourse loan, the amount you realize includes the full amount of the note assumed by the buyer even though the amount of the note exceeds the fair market value of the property.

Payment of cash. If you trade property for other property and in addition pay cash, the amount you realize is the fair market value of

the property you receive. You determine your gain or loss by subtracting your adjusted basis (the cash you pay plus the adjusted basis of the property you traded in) from the amount you realize.

Example 1. You sell stock which you had pledged as security for a bank loan of $8,000. Your basis in the stock is $6,000. The buyer pays off your bank loan and pays you $20,000 in cash. The amount realized is $28,000 ($20,000 plus $8,000). Your gain is $22,000 ($28,000 minus $6,000).

Example 2. You trade A Company stock with an adjusted basis of $7,000 for B Company stock with a fair market value of $10,000, which is your amount realized. Your gain is $3,000 ($10,000 minus $7,000). If you also receive a note for $6,000 that has a discount value of $4,000, your gain is $7,000 ($10,000 plus $4,000 minus $7,000).

No gain or loss. You may be required to use a basis for figuring gain different from that used for figuring loss. In this case, you may not have a gain or loss. See *Other Basis* in Chapter 15. In these situations, if you use the basis for determining a gain and figure a loss, and then use the basis for determining a loss and figure a gain, you will have neither a gain nor a loss.

Example. You receive a gift of investment property having an adjusted basis of $10,000 at the time of the gift. The fair market value at the time of the gift is $9,000. You later sell the property for $9,500. You have neither gain nor loss. Your basis for figuring gain is $10,000, and $10,000 minus $9,500 results in a $500 loss. Your basis for figuring loss is $9,000, and $9,500 minus $9,000 results in a $500 gain.

Nontaxable Trades

Certain trades or exchanges are nontaxable. This means that any gain from the exchange is not taxed, and any loss cannot be deducted. In other words, even though you may realize a gain or loss on the exchange, it will not be recognized for tax purposes. The property you get carries over the basis of the property you had before the exchange.

Like-kind exchanges. If you traded business or investment property for other business or investment property of a like kind, you must postpone tax on the gain or postpone deducting the loss until you sell or dispose of the property you receive. To be nontaxable, a like-kind exchange must meet all six of the following conditions —

1) The property must be business or investment property. You must hold both the property you trade and the property you receive for business or investment purposes. Neither property may be used for personal purposes, such as your home or family car.
2) The property must not be property held for sale. Neither the property you trade nor the property you receive may be property you sell to customers, such as merchandise. It must be property held for investment, or property held for productive use in your trade or business.
3) There must be an exchange of like-kind property. The exchange of real estate for real estate and the exchange of personal property for similar personal property are exchanges of like-kind property. The trade of an apartment house for a store building or a panel truck for a pickup truck are like-kind exchanges. The exchange of a piece of machinery for a store building is not a like-kind exchange.
4) The property must be tangible property. These rules and benefits do not apply to exchanges of stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidence of indebtedness or interest, including the exchange of partnership interests. However, you may have a nontaxable exchange of corporate stocks, as discussed later under *Corporate stocks.*
5) The property must meet the identification requirement. The property to be received must be identified on or before the day that is 45 days after the date of transfer of the property given up in the exchange.
6) The exchange must meet the completed transaction requirement. The property must be received on or before the earlier of:
   a) The 180th day after the date on which you transfer the property given up in the transfer, or
   b) The due date, including extensions, for your tax return for the year in which the transfer of the property given up occurs.

Partially nontaxable exchange. If, in addition to like-kind property, you receive money or nonlike-kind property, and the above conditions are met, you have a partially nontaxable trade. You are taxed on the gain you realize, but only to the extent of the cash and the fair market value of the nonlike-kind property you receive. You may not deduct a loss.

If you pay money in addition to transferring property in exchange for like-kind property, you have no taxable gain or deductible loss.

If you give up nonlike-kind property in addition to the like-kind property, you must recognize gain or loss only on the nonlike-kind property you give up. The gain or loss is the difference between the fair market value of the nonlike-kind property and the property's adjusted basis. See Chapter 1 of Publication 544 for more information about partially nontaxable exchanges.

To figure the basis of the property received, see *Nontaxable Exchanges* in Chapter 15.

How to report. You must report the exchange of business or investment like-kind property on Schedule D of Form 1040 (or Form 4797, *Sales of Business Property,* whichever applies) and on **Form 8824,** *Like-Kind Exchanges.*

For exchanges reported on Schedule D, write "From Form 8824" in column (a). Skip columns (b) through (e), and enter the gain or loss from Form 8824, if any, in column (f) or (g). (See Chapter 18 to determine whether to use line 2a, 2d, 9a, or 9d.) At the top of Schedule D, write the words "Like-Kind Exchange" or, if one or more exchanges involved a related party, write "Related Party Like-Kind Exchange."

To compute any partial gains or losses and for more information on like-kind exchanges, see the instructions for Form 8824. For more information on how to report the sale of business property, see Publication 544.

Transfers of property between spouses or incident to divorce. Generally, no gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse, or a former spouse if incident to a divorce. This nonrecognition rule does not apply if the recipient-spouse or former spouse is a nonresident alien. The rule also does not apply to a transfer in trust to the extent the adjusted basis of the property is less than the amount of the liabilities assumed and liabilities on the property.

Any transfer of property to a spouse or former spouse on which gain or loss is not recognized is treated by the transferee as acquired by gift and is not considered as a sale or exchange. The transferee's basis in the property will be the same as the adjusted basis of the transferor immediately before the transfer. This carryover basis rule applies whether the adjusted basis of the transferred property is less than, equal to, or greater than its fair market value at the time of transfer. This rule applies for purposes of determining loss as well as gain. Any gain recognized on a transfer in trust increases the basis.

A transfer of property is incident to a divorce if the transfer occurs within one year after the date on which the marriage ends, or if the transfer is related to the ending of the marriage.

For more information, see Publication 504, *Tax Information for Divorced or Separated Individuals.*

Corporate stocks. The following trades of corporate stocks generally do not result in a taxable gain or a deductible loss.

Stock for stock of the same corporation. You can exchange common stock for common stock or preferred stock for preferred stock in the same corporation without having a recognized gain or loss. This is true for a trade between two persons as well as a trade between a stockholder and a corporation.

In some instances, you may trade common stock for preferred stock, preferred stock for common stock, or stock in one corporation for stock in another corporation without having a recognized gain or loss. These trades must be part of mergers, recapitalizations, transfers to controlled corporations, bankruptcies, corporate divisions, corporate acquisitions, or other corporate reorganizations.

Convertible stocks and bonds. You will not have a recognized gain or loss if you convert bonds into stock or preferred stock into common stock of the same corporation according to a conversion privilege in the terms of the bond or the preferred-stock certificate, except where gain is specifically required to be recognized.

Property for stock of a controlled corporation. If you transfer property to a corporation solely in exchange for stock in that corporation, and immediately after the trade you are in control of the corporation, you ordinarily will not recognize a gain or loss. This rule applies both to individuals and to groups who transfer property to a corporation. It does not apply if the corporation is an investment company.

However, if you had a gain from the disposition of depreciable property from this transaction, you may be taxed on part of the gain. See *Dispositions of Depreciable Property* in Publication 544 for more information.

For this purpose, to be in control of a corporation, you or your group of transferors must own, immediately after the exchange, at least 80% of the total combined voting power of all classes of stock entitled to vote, and at least

80% of the outstanding shares of each class of nonvoting stock of the corporation. See *Exchanges of Corporate Stock* in Publication 544 for information about other exchanges for corporate stocks.

If this provision applies to you, you must file a complete statement of all facts pertinent to the exchange with your return.

For more information on trades of stock, see *Nontaxable Trades* in Publication 550.

Insurance policies and annuities. You will not have a recognized gain or loss if you trade:

1) A life insurance contract for another life insurance contract or for an endowment or an annuity contract,
2) An endowment contract for an annuity contract, or for another endowment contract that provides for regular payments beginning at a date not later than the beginning date under the old contract, or
3) An annuity contract for another annuity contract.

The insured or annuitant must stay the same as under the original contract. Exchanges of these contracts that are not included in this list, such as an annuity contract for an endowment contract, or an annuity or endowment contract for a life insurance contract, are taxable.

U.S. Treasury notes or bonds. You can trade certain issues of U.S. Treasury obligations for other issues, designated by the Secretary of the Treasury, with no gain or loss recognized on the trade. See *U.S. Treasury notes or bonds* under *Nontaxable Trades* in Publication 550 for information about the tax treatment of income from these investments. For other information on Treasury notes or bonds, write to:

Bureau of the Public Debt
U.S. Department of Treasury
Washington, D.C. 20239–1000

Related Party Transactions

Special rules apply to the sale or trade of property between related parties.

Like-kind exchanges. Generally, if you trade business or investment property for other business or investment property of a like kind, no gain or loss is recognized. See *Like-kind exchanges* discussed earlier under *Nontaxable Trades*.

This rule applies to exchanges of property between related parties, defined next under *A loss on the sale or trade* of property. However, if either related party disposes of the like-kind property within 2 years after the exchange, the gain or loss on the exchange must be recognized. Each related person must report any gain or loss not recognized on the original exchange on the tax return filed for the year in which the later disposition occurred. This rule applies to all transfers after July 10, 1989, except those made under binding contracts in effect on that date and up to the time of transfer.

These rules generally *do not apply* to:

Dispositions due to the death of either related person,

Involuntary conversions (see Publication 544), or

Exchanges or dispositions whose main purpose is not the avoidance of federal income tax.

The 2-year period does not include the period during which the holder's risk of loss is substantially diminished by:

The holding of a put on the property,

The holding by another person of a right to acquire the property, or

A short sale or any other transaction.

A loss on the sale or trade of property, other than a distribution in complete liquidation of a corporation, is not deductible if the transaction is directly or indirectly between you and the following related parties:

1) Members of your family — this includes only your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
2) A corporation in which you directly or indirectly own more than 50% in value of the outstanding stock (see *Constructive ownership of stock*, later).
3) A tax-exempt charitable or educational organization that is directly or indirectly controlled, in any manner or by any method, by you or by a member of your family, whether or not this control is legally enforceable.

In addition, a loss on the sale or trade of property is not deductible if the transaction is directly or indirectly between the following related parties:

1) A grantor and fiduciary, and the fiduciary and beneficiary, of any trust,
2) Fiduciaries of two different trusts, and the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts,
3) A trust fiduciary and a corporation of which more than 50% in value of the outstanding stock is directly or indirectly owned, by or for the trust, or by or for the grantor of the trust,
4) A corporation and a partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest, or the profits interest, in the partnership,
5) Two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation,
6) Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation, or
7) Two corporations that are members of the same controlled group (under certain conditions, however, such losses are not disallowed but must be deferred).

If you sell or trade to a related party a number of blocks of stock or pieces of property in a lump sum, you must figure the gain or loss separately for each block of stock or piece of property. The gain on each item may be taxable. However, you cannot deduct the loss on any item. Also, you cannot reduce gains from the sales or any of these items by losses on the sales of any of the other items.

Indirect transactions include sales through a stock exchange. You cannot deduct your loss on the sale of stock through your broker if, for example, under a prearranged plan a related person or entity buys the same stock that you had owned.

Constructive ownership of stock. In determining whether a person ***directly or indirectly*** owns any of the outstanding stock of a corporation, the following rules apply.

Rule 1. Stock directly or indirectly owned, by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.

Rule 2. An individual is considered to own the stock that is directly or indirectly owned by or for his or her family. Family includes only brothers and sisters, half-brothers and half-sisters, spouse, ancestors, and lineal descendants.

Rule 3. An individual owning (other than by applying rule 2) any stock in a corporation is considered to own the stock that is directly or indirectly owned by or for his or her partner.

Rule 4. Stock constructively owned by a person under rule 1 is treated as actually owned by that person, for applying rules 1, 2, or 3. But stock constructively owned by an individual under rule 2 or 3 is not treated as owned by that individual for again applying either rule 2 or 3 to make another person the constructive owner of the stock.

Property received from a related party. If you sell or trade property that you got from a related party, you recognize the gain only to the extent it is more than the loss previously disallowed to the transferor. This rule applies only if you are the original transferee and you acquired the property by purchase or exchange. This rule does not apply if the transferor's loss was disallowed because of the wash sale rules, described in Publication 550 under *Wash Sales*.

Example 1. Your brother sells you stock with a cost basis of $10,000 for $7,600. Your brother cannot deduct the loss of $2,400. Later, you sell the same stock to an unrelated party for $10,500, thus realizing a gain of $2,900. Your reportable gain is $500: the $2,900 gain minus the $2,400 loss not allowed to your brother.

Example 2. Assume the same facts as in *Example 1*, except that you sold the stock for $6,900 instead of $10,500. Your recognized loss is only $700 ($7,600 basis minus $6,900). You cannot deduct the loss that was not allowed to your brother.

Gain on sale or trade of depreciable property. If you have a recognized gain on the sale or trade of property, including a leasehold or a patent application, that is depreciable property in the hands of the party who receives it, the capital gain provisions do not apply and the gain is ordinary income if the transaction is between you and a controlled entity, or you and a trust in which you or your spouse is a beneficiary. See Chapter 2 in Publication 544 for more information.

Capital Assets and Noncapital Assets

For the most part, everything you own and use for personal purposes, pleasure, or investment is a capital asset. Some examples are stocks or bonds held in your personal account; a house owned and used by you and your family;

household furnishings; a car used for pleasure or commuting; coin or stamp collections; gems and jewelry; gold, silver, or any other metal.

Capital assets do not include:

1) ***Property held mainly for sale to customers*** or property that will physically become a part of the merchandise that is for sale to customers;
2) ***Depreciable property*** used in your trade or business, even though fully depreciated;
3) ***Real property*** used in your trade or business;
4) ***A copyright, a literary, musical, or artistic composition, a letter or memorandum,*** or similar property that you created by your personal efforts; that was prepared or produced for you as a letter, memorandum, or similar property; or that you acquired under circumstances (for example, by gift) entitling you to the basis of a person who created the property or for whom it was prepared or produced;
5) ***Accounts or notes receivable*** acquired in the ordinary course of a trade or business, or for services rendered as an employee, or from the sale of any of the properties described in (1); and
6) ***U.S. Government publications*** that you received from the government free or for less than the normal sales price, or that you acquired under circumstances entitling you to the basis of someone who received the publications free or for less than the normal sales price.

Noncapital assets. Noncapital assets include the six items listed above as exceptions to capital assets.

Capital or Ordinary Gain or Loss

If you have a taxable gain or a deductible loss from a transaction, it may be either a capital gain or loss or an ordinary gain or loss, depending on the circumstances. In some situations, part of your gain or loss may be a capital gain or loss and part may be an ordinary gain or loss. For information about transactions that are not discussed here, refer to those IRS publications described at the beginning of this chapter.

This part discusses the tax treatment of gains and losses from several types of transactions.

Character of gain or loss. It is important for you to properly distinguish or classify your gains and losses as either ordinary or capital gains or losses and as either short-term or long-term gains or losses. These distinctions are essential to correctly arrive at your net capital gain or loss. The correct classification of your gains and losses is important for determining the limit on capital losses.

For information about determining whether your gain or loss was a short-term or long-term capital gain or loss, see the discussion under *Holding Period*, later in this chapter. For more information about figuring your capital gain income and determining your allowable capital losses, see Chapter 16.

Property Held for Personal Use

Property held for personal use is a capital asset. Gain from a sale or exchange of such property is a capital gain. Losses from sales and exchanges of such property are not deductible, unless they result from personal casualties or thefts as discussed in Chapter 26.

Investment Property

Investment property is a capital asset and a gain or loss from its sale or exchange is generally a capital gain or loss.

Gold, silver, stamps, coins, gems, etc., are capital assets except when they are held for sale by a dealer. Any gain or loss you have from their sale or trade generally is a capital gain or loss.

Stocks, stock rights, and bonds (including stock received as a dividend) are capital assets except when held for sale by a securities dealer. However, if you own small business stock, see the discussion under *Losses on Small Business Stock*, in Publication 550.

Worthless securities. Stocks, stock rights, and corporate or government bonds with interest coupons or in registered form, which became worthless during the tax year, are treated as though they were capital assets sold on the last day of the tax year if they were capital assets in your hands. To determine whether they are long-term or short-term capital assets, you are considered to have held the stocks or securities until the last day of the year in which they became worthless. See *Holding Period*, later.

If you are a cash method taxpayer and make payments on a negotiable promissory note that you issued for stock that became worthless, you can deduct these payments as losses in the years you actually make the payments. Do not deduct them in the year the stock became worthless.

Discounted debt instruments. Treat your gain or loss on the sale, redemption, or retirement of a bond or other evidence of indebtedness originally issued at a discount as follows.

Treat gains on ***short-term federal, state, or local government obligations*** as ordinary income up to the ratable share of the acquisition discount. This treatment applies to obligations that have a fixed maturity date not more than one year from the date of issue. However, this treatment does not apply for state or local government obligations with tax-exempt interest. Any gain in excess of the ratable share of the acquisition discount is capital gain. Any loss is capital loss. ***Acquisition discount*** is the excess of the stated redemption price at maturity over your basis in the obligation.

However, do not treat such gains as income to the extent you previously included the discount in income. This amount increases your basis in the obligation. See *Discount on Short-Term Obligations* in Publication 550 for more information.

Treat gains on ***short-term nongovernmental obligations*** (whether or not tax exempt) as ordinary income up to the ratable share of original issue discount (OID). This treatment applies to obligations that are not short-term governmental obligations, and that have a fixed maturity date of not more than one year from the date of issue.

However, to the extent you previously included the discount in income, you do not have to include it in income again. This amount increases your basis. See *Discount on Short-Term Obligations* in Publication 550, for more information.

Long-term debt instruments issued after 1954, and before May 28, 1969 (or before July 2, 1982, if a government issue). If you sell, exchange, or redeem for a gain one of these debt instruments, the part of your gain due to the OID is interest income at the time of the sale or redemption. The balance of the gain is capital gain. If, however, there was an intention to call the debt instrument before maturity, the entire amount of OID is treated as ordinary income at the time of sale. This treatment of taxable gain also applies to corporate instruments issued after May 27, 1969, under a written commitment that was binding on that date and thereafter.

Original Issue Discount (OID). A long-term debt instrument, such as a bond, note, or other evidence of indebtedness, generally has OID when it is issued for a price that is less than its stated redemption price at maturity (principal amount). The amount of OID is the difference between the issue price of the instrument and its principal amount. OID is a form of interest; however, you report OID as it accrues whether or not you receive any payments from the bond issuer. You can disregard the OID if it is less than one-fourth of 1% (.0025) of the stated redemption price multiplied by the number of full years from the date of original issue to maturity. All long-term instruments that pay no interest prior to maturity are presumed to be issued at a discount. See *Original Issue Discount (OID)* in Chapter 8 for more information.

Long-term corporate debt instruments issued after May 27, 1969, and government instruments issued after July 1, 1982. If you hold one of these debt instruments, you must include a part of the OID in your gross income each year. Your basis in the instrument is increased by the amount of OID you have included in your gross income. See *Original Issue Discount (OID)* in Chapter 8 for information about the OID that you must report on your tax return.

If you sell or exchange a debt instrument before it reaches maturity, your gain on the sale is a capital gain, provided the debt instrument was a capital asset. Any amount that you receive on the retirement of a debt instrument is treated in the same way as if you had sold or exchanged that instrument.

However, if at the time the instrument was originally issued there was an intention to call it before its maturity, your gain on the sale of the instrument is ordinary income to the extent of the entire OID reduced by any amounts of OID previously includible in your income. The rest of the gain is capital gain.

See *Capital or Ordinary Gain or Loss* in Publication 550 for more information about the tax treatment on the sale or redemption of discounted debt instruments.

Tax-exempt state and local government bonds. Any gain from market discount is taxable as a capital gain on disposition or redemption of tax-exempt bonds. You figure the market discount by subtracting the price you paid for the bond from the sum of the original issue price of the bond and the amount of accumulated OID from the date of issue that represented interest to any earlier holders.

If you sold tax-exempt state and local government bonds issued after September 3, 1982, and acquired after March 1, 1984, your adjusted basis at the time of disposition is figured by adding accrued OID to your basis. You must accrue OID on tax-exempt obligations

under the same method used for OID on corporate obligations issued after July 1, 1982.

Stripped tax-exempt bonds or coupons. You must accrue OID on any stripped tax-exempt bond or coupon. A portion of this OID may be taxable. See *Stripped Bonds and Coupons* in Publication 550 for more information about determining the basis of these obligations.

Notes of individuals. If the evidence of indebtedness you bought at a discount was issued by an individual, its retirement generally will not be given capital gain treatment. But if you sell the discounted instrument to someone other than the original borrower, any gain is a capital gain as long as it was not acquired in the ordinary course of your trade or business for services rendered or from the sale of inventory. In figuring your adjusted basis in the note, do not reduce your original basis by any interest payments or by the part of the principal payments you received that is taxable discount income.

Example. You bought, for $6,000, a note of an individual on which $10,000 was still owed. You receive principal payments totaling $4,000, and then sell the note to someone other than the original borrower for $3,800. Only 60% ($6,000/$10,000) of the $4,000 is a return of your investment. The balance is discount income. You reduce your cost by $2,400 ($4,000 × 60%) to figure your adjusted basis. Your capital gain is $200, figured as follows:

Selling price of note		$3,800
Minus adjusted basis of note:		
Cost of note	$6,000	
Minus return on investment	2,400	3,600
Capital gain		$ 200

The OID rules discussed in Chapter 6, under *Original Issue Discount (OID)*, apply to obligations issued by individuals after March 1, 1984. The OID rules will not apply to loans between individuals in amounts of $10,000 or less (including the outstanding amounts of prior loans) if the lender is not in the business of lending money, except if a principal purpose of the loan is to avoid federal tax.

Obligations issued in bearer form. Generally, any loss on a registration-required obligation held in bearer form is not deductible, and any gain on the sale or other disposition of such obligation is ordinary income, unless the issuer was subject to a tax on the issuance of the obligation.

A registration-required obligation is any obligation except an obligation:

1) That is issued by a natural person.
2) That is not of a type offered to the public.
3) That has a maturity at the date of issue of not more than 1 year.
4) That was issued before 1983.

Loss on deposits in an insolvent or bankrupt financial institution. If you can reasonably estimate your loss on a deposit because of the bankruptcy or insolvency of a qualified financial institution, you can choose to treat the amount as either a casualty loss or an ordinary loss in the current year. Claim the loss as an itemized deduction. Otherwise, you can wait until the year of final determination of the actual loss and treat the amount as a nonbusiness bad debt (discussed later under *Nonbusiness Bad Debts*) in that year.

If you claim a casualty loss, attach Form 4684, *Casualties and Thefts*, to your return. Each loss must be reduced by $100. Your total casualty losses for the year are reduced by 10% of your adjusted gross income.

If you claim an ordinary loss, report it as a miscellaneous itemized deduction on Schedule A (Form 1040). The maximum amount you can claim is $20,000 ($10,000 if you are married filing separately) reduced by any expected state insurance proceeds. Your loss is subject to the 2% of adjusted gross income limit. You cannot choose to claim an ordinary loss if any part of the deposit is federally insured.

You cannot choose either of these methods if:

- You own at least 1% of the financial institution,
- You are an officer of the institution, or
- You are related to such an owner or officer.

If the actual loss that is finally determined is more than the amount deducted as an estimated loss, you can claim the excess loss as a bad debt. If the actual loss is less than the amount deducted as an estimated loss, you must include in income (in the final determination year) the excess loss claimed.

Sale of annuity. The part of any gain on the sale of an annuity contract before its maturity date that is attributable to interest accumulated on the contract is ordinary income.

Nonbusiness Bad Debts

If someone owes you money that you cannot collect, you have a bad debt. You may be able to deduct the amount owed to you when you figure your tax for the year the debt becomes worthless. For a bad debt to qualify for the deduction, there must be a true creditor-debtor relationship between you and the person or organization that owes you the money. There must be a legal obligation to pay you a fixed sum of money. You must realize a loss because of your inability to collect the money owed to you.

Bad debts that you did not get in the course of operating your trade or business are nonbusiness bad debts. To be deductible, nonbusiness bad debts must be totally worthless. You cannot deduct a partially worthless nonbusiness bad debt.

Nonbusiness bad debts are deducted only as short-term capital losses on Schedule D (Form 1040), *Capital Gains and Losses*. There are limits on how capital losses may be deducted. For a discussion of these limits, see Chapter 18.

For more information, see *Nonbusiness Bad Debts* in Publication 550.

Reporting bad debts. Nonbusiness bad debts are deducted as short-term capital losses on Schedule D (Form 1040).

In Part I, line 2d of Schedule D, enter the name of the debtor and "schedule attached," in column (a), and the amount of the bad debt in column (f). Use a separate line for each bad debt.

For each bad debt, attach a statement to your return that contains:

1) A description of the debt, including the amount, and the date it became due,
2) The name of the debtor, and any business or family relationship between you and the debtor,
3) The efforts you made to collect the debt, and
4) Why you decided the debt was worthless. For example, you could show that the borrower has declared bankruptcy, or that legal action to collect would probably not result in payment of any part of the debt.

Losses on Small Business Stock

You are allowed to deduct as an ordinary loss, rather than as a capital loss, your loss on the sale, exchange, or worthlessness of certain stock you own in a small business corporation or certain stock in a small business investment company. Gain on this stock is capital gain and is reported on Schedule D (Form 1040) if the stock is a capital asset in your hands. See *Losses on Small Business Stock* and *Losses on Small Business Investment Company Stock* in Publication 550.

Holding Period

If you sold or traded investment property, you must determine whether the gain or loss is a short-term or long-term capital gain or loss.

Character of gain or loss. It is important for you to properly distinguish or classify your gains and losses as either ordinary or capital gains or losses and as either short-term or long-term gains or losses. The correct classification of your gains and losses is essential to correctly arrive at your net capital gain or loss and to determine the limit on your capital losses. For information about determining whether your gain or loss was an ordinary gain or loss or a capital gain or loss, see the discussion under *Capital or Ordinary Gain or Loss*, earlier in this chapter. For more information about figuring your capital gain income and determining your allowable capital loss, see Chapter 18.

Long term or short term. If you hold investment property ***more than one year,*** your gain or loss is a ***long-term*** capital gain or loss. If you hold the property ***one year or less,*** your gain or loss is a ***short-term*** capital gain or loss.

To figure how long you held the investment property, start counting on the date after the day you acquired the property. The same date of each following month is the beginning of a new month regardless of the number of days in the preceding month. The day you disposed of the property is part of your holding period.

Example. If you bought an asset on February 1, 1990, you should start counting on February 2. The 2nd of each following month is the beginning of a new month. If you sell the asset on February 1, 1991, your holding period is not more than one year and you will have a short-term capital gain or loss. If you sell it on February 2, 1991, your holding period is more than one year and you will have a long-term capital gain or loss.

Securities traded on established market. For securities traded on an established securities market, the holding period begins the day after the ***trading date*** you bought the securities, and ends on the trading date you sold them. Ignore the settlement date for holding period purposes.

Example. You are a cash method, calendar-year taxpayer. You sold stock at a gain on December 28, 1990. According to the rules of the stock exchange, the sale was closed by delivery of the stock 5 trading days after the sale, on January 7, 1991. You received payment of the sales price on that same day.

Report your gain on your 1990 return, even though you received the payment in 1991. The gain is long term or short term depending on whether you held the stock more than one year. Your holding period ended on December 28. If you had sold the stock at a loss, you would also report it on your 1990 return.

Nontaxable trades. If you acquire investment property in a trade for other investment property and your basis for the new property is figured, in whole or in part, by your basis in the old property, your holding period of the new property begins on the day following the date you acquired the old property. Chapter 15 discusses basis.

Gifts. If you receive a gift of property and your basis in it is figured by using the donor's basis, your holding period includes the donor's holding period. See *Property Received as a Gift* in Chapter 15.

If your basis is determined by the fair market value of the property, your holding period starts on the day after the date of the gift.

Inheritance. If you inherit investment property and your basis for it is determined with reference to its fair market value at the date of the decedent's death, or at the alternate valuation date, or as the decedent's adjusted basis (for appreciated property), your gain or loss on any later disposition of such property is treated as a long-term capital gain or loss. You are considered to have held the property for more than one year, even if you dispose of it within one year after the decedent's death. See *Inherited Property* in Publication 551, *Basis of Assets*.

Real property. To figure how long you have held real property bought under an unconditional contract, start counting on the earlier of the day after you received title to it, or the day after you took possession and assumed the burdens and privileges of ownership. However, taking delivery or possession of real property under an option agreement is not enough to start the holding period. The holding period cannot start until there is an actual contract of sale. The holding period of the seller cannot end before that time.

Mutual fund stock. If you received exempt-interest dividends on mutual fund stock that you held 6 months or less and sold at a loss, you cannot claim the part of the loss that is equal to or less than the exempt-interest dividends. You must report the rest of the loss as a short-term capital loss.

See Publication 564, *Mutual Fund Distributions*, for more information on mutual fund distributions.

Real estate investment trust (REIT). If you received a capital gain distribution on REIT stock that you held 6 months or less and sold at a loss, you must report as a long-term capital loss the part of the loss that is equal to, or less than, the long-term capital gain distribution. This rule does not apply to dispositions of stock under a periodic liquidation plan. See *Capital Gain Distributions* in Chapter 9 for information on capital gain distributions.

Automatic investment service and dividend reinvestment plans. If you take part in a plan to buy stock through a bank or other agent, the date the bank or other agent buys the stock is your purchase date for figuring the holding period of that stock. If a full share or part of a share was bought over a period of more than one purchase date, the holding period is a split holding period. A part of the full share or part of a share is considered to have been bought on each date that stock was bought by the bank or other agent with the proceeds of available funds.

Nontaxable stock dividend. The holding period for new stock you received as a nontaxable stock dividend begins on the same day as the holding period of the old stock. This rule also applies to stock acquired in a "spin-off," which is a distribution of stock or securities in a controlled corporation.

Nontaxable stock rights. Your holding period for nontaxable stock rights begins on the same day as the holding period of the underlying stock. The holding period for stock acquired through the exercise of stock rights begins on the date the right was exercised.

17. Selling Your Home

Important Reminders

Deceased spouse. If your spouse dies after you sell your old home and before a new home is purchased, the tax on the gain from the sale of the old home can be postponed if the basic requirements are met and:

1) You were married when your spouse died, and
2) You use the new home as your main home.

See *New Home*, later.

Change of address. If you change your mailing address, be sure to notify the Internal Revenue Service using Form 8822, *Change of Address*. Mail it to the Internal Revenue Service Center for your old address (addresses for the Service Centers are on the back of the form). If you are changing both your home and business addresses, you should complete two separate forms.

This chapter explains how you treat any gain from selling your main home, and how you can postpone the tax on all or part of your gain on the sale of your home. You must use Form 2119, *Sale of Your Home*, to report the sale of your main home, whether or not you buy another main home.

If you exchange your home for other property, the exchange is treated as the sale of your home. In this chapter, "sale" also means "exchange," and the same rules apply. See *Trading homes*, later.

Gain or Loss

If you sell your main home, you may be able to postpone paying tax on all or part of the gain from the sale. If you buy a new home, and the purchase price of the new home is at least as much as the adjusted sales price of the old home, you must postpone the tax on all the gain from the sale. If you do not buy a new home, or if the purchase price of the new home is less than the adjusted sales price of the old home, you will be subject to tax on all or part of the gain, unless you are age 55 or older and qualify to exclude the gain as explained later.

Loss on sale. You cannot deduct a loss on the sale of your home. The loss has no effect on the basis of your new home.

Purchase price at least as much as sales price. Your entire gain on the sale of your home is not taxed at the time of the sale if, within 2 years before or 2 years after the sale, you buy and live in another home that costs at least as much as the adjusted sales price (described later) of the old home. If you are on active duty in the armed forces, or if your tax home is outside the United States, the 2-year period may be suspended. See *Members of the armed forces* and *People abroad*, later.

Purchase price less than sales price. If the purchase price of your new home is less than the adjusted sales price of your old home, and you buy and live in the new home within the time period given above, the gain taxed in the year of the sale is the lesser of:

1) The gain on the sale of the old home, or
2) The amount by which the adjusted sales price of the old home is more than the purchase price of the new home.

You need not use the same funds received from the sale of your old home to buy or build your new home. For example, you can use less cash and increase the amount of your mortgage loan.

Refinancing. If you refinanced your home in 1990, see Chapter 24.

Postponement of Gain

You **must** postpone tax on the gain on the sale of your main home if you buy a new main home within the replacement period and it costs at least as much as the adjusted sales price of the old home. This section explains the time for replacement, how to determine the gain, and how to report the sale.

The tax on the gain is **postponed, not forgiven.** Any gain that is not taxed in the year you sell your old home is subtracted from the cost of your new home. This gives you a lower basis in the new home. If you sell the new home in a later year and again replace it, you can continue to postpone tax on your gain.

Example. You sold your home in 1990 for $50,000 and had a $5,000 gain. Within 2 years, you bought another home for $60,000. The $5,000 gain will not be taxed in 1990 (the year of sale), but you must subtract it from the $60,000. This makes the basis of your new home $55,000. If you later sell the new home for $66,000, and do not buy and live in a replacement home within the required time, you will be subject to tax on the $11,000 gain ($66,000 minus $55,000) in the sale year.

Main Home

Usually, the home in which you live is your main home. The home you sell and the one you buy to replace it must both qualify as your main home. *Property partly used as your home* and *Home changed to rental property* are discussed later.

A houseboat or mobile home can be your main home. A cooperative apartment or condominium can also be your main home.

Furniture, appliances, and similar items that are not fixtures (permanent parts of the property) generally are not part of your main home.

Land. If you sell the land on which your main home is located, but not the house itself, you cannot postpone tax on any gain you have from the sale of the land. For example, you sell the land on which your main home is located. Within the replacement period, you buy another piece of land and move your house to it. This sale is not considered a sale of your main home, and you cannot postpone tax on any gain on the sale.

More than one home. If you have more than one home, only the sale of your main home qualifies for postponing the tax. If you have two homes and live in both of them, your main home is the one you live in most of the time.

Example. You own and live in a house in town and also own beach property, which you use in the summer months. The town property is your main home; the beach property is not.

If you own a house, but live in another house you rent, the rented home is your main home. But if a house you own is your main home, you can temporarily rent it out before its sale without changing its character as your main home.

Time for Replacement

The time allowed to replace your old home, occupy your new home, and postpone tax on the sale is a 48-month period. You must buy (or build) and live in another house within 2 years before or 2 years after the date of sale of your old home to postpone the tax on the gain on the sale.

Example. You buy and move into a new home that you use as your main home on April 20, 1990, before you sell your old home. You have until April 20, 1992, a period of 24 months (unless the time is suspended, explained later) to sell your old home and postpone tax on any gain.

Occupancy test. You must physically live in the replacement home as your main home within the required period. If you move furniture or other personal belongings into the new home but do not actually live in it, you have not met the occupancy test.

No added time beyond the specified period is allowed. If you had a gain on the sale of your home, you must replace the old home and occupy the new home within the specified period. No additional time is allowed, even if conditions beyond your control keep you from doing it. For example, destruction of the new home while it was being built would not extend the replacement period. However, there may be a suspension of time, discussed later, for members of the armed forces or people who work overseas.

If you do not replace the home in time, you must file an amended return for the year of sale and report the entire gain on the sale of your old home. Also, if you began building your new home within the specified period but for any reason were unable to live in it within 2 years, no more time is allowed for occupancy. You must report your entire gain on an amended return for the year of the sale.

Members of the armed forces. The replacement period after the sale of your old home is suspended while you serve on extended active duty in the armed forces. Extended active duty is defined as serving under a call or order for more than 90 days or for an indefinite period. The suspension applies only if your service begins before the end of the 2-year period. This time plus any period of suspension is limited to 4 years (8 years in certain cases) from the sale of your old home. For more information, see *Members of the armed forces* in Publication 523, *Tax Information on Selling Your Home.*

Overseas military assignment. The replacement period is suspended while you are stationed outside the United States. The replacement period may also be suspended while you are required to live in on-base quarters following your return from a tour of duty outside the United States. In this case, it will be suspended if you are required to live on base because you are stationed at a remote site where the Secretary of Defense has determined adequate off-base housing is not available. If you sold your house after July 18, 1984, the replacement period will not expire until one year after the last day you are stationed outside the United States, or the last day you are required to reside in government quarters on base. The replacement period, plus any period of suspension, is limited to 8 years after the date of the sale of your old home.

If you qualify for the additional one-year extension and have already filed an income tax return reporting gain from the sale of a home that can be postponed by this change, you can file Form 1040X, *Amended U.S. Individual Income Tax Return,* to claim a refund. See Chapter 1 for information on the time allowed to file an amended return.

People abroad. The replacement period is also suspended while you have your tax home (place where you live and work) outside the United States. This suspension applies only if your stay abroad begins before the end of the 2-year replacement period. The replacement period, plus the period of suspension, is limited to 4 years from the date of sale of your old home. For more information, see *People abroad* in Publication 523. For a discussion of tax home, see Chapter 28.

Basis

Basis is a way of measuring your investment in property for tax purposes. Whether you bought your home, hired a contractor to build it for you, built it yourself, or received it in another way, it is important that you know its basis.

The basis of property you buy is usually the cost or purchase price. While you own the property, you may make adjustments (increases or decreases) to the basis. If you change the original basis, you have adjusted the basis.

This adjusted basis is used to figure gain or loss when you sell or otherwise dispose of the property. You also must know the adjusted basis at the time of a casualty to determine your deductible loss from the casualty. If you change your home to rental or business use, your depreciation is based on the fair market value of the home or its adjusted basis at the time of the change, whichever is less.

You will also find information on basis and adjusted basis in Chapter 15.

Adjusted basis. This is your original basis ***increased*** or ***decreased*** by certain amounts.

Increases to basis include:

1) Improvements.
2) Additions.
3) Other capital expenses.
4) Special assessments for local improvements.
5) Amounts spent to restore damaged property.

Decreases to basis include:

1) Insurance reimbursement for casualty losses.
2) Deductible casualty loss not covered by insurance.
3) Payment received for easement or right-of-way granted.
4) Depreciation deduction if you used your home for business or rental purposes.
5) Gain from sale of old home on which tax was postponed.

No change to basis includes certain settlement fees:

1) Points.
2) Fire insurance premiums.
3) Mortgage insurance premiums.
4) Charges for services concerning occupancy of the house.

Improvements add to the value of your home, prolong its useful life, or adapt it to new uses. Improvements are added to the basis of your property.

Repairs maintain your home in good condition. They do not add to its value or prolong its life and are not added to the basis of your property.

Examples. Putting a recreation room in your unfinished basement, adding another bathroom or bedroom, putting up a fence, putting in new plumbing or wiring, putting on a new roof, or paving your driveway are improvements you add to basis. On the other hand, repainting your house inside or outside, fixing your gutters or floors, repairing leaks or plastering, and replacing broken window panes are examples of repairs.

Recordkeeping. You should save receipts and other records for all improvements, additions, and other items that affect the basis of your home. Ordinarily, you must keep records for 3 years after the due date for filing your return for the tax year in which you sold, or otherwise disposed of, your home. But if you use the basis of your old home in figuring the basis of your new one, such as when you sell your old home and postpone tax on any gain, you should keep those records as long as they are needed for tax purposes.

Old Home

To figure the gain on the sale of your old home, you must know the selling price and the amount realized.

Your gain is the amount realized minus the adjusted basis of the home.

Amount realized. The amount realized is the selling price minus selling expenses.

Selling price. The selling price is the total amount you receive for the property, including money, all notes, mortgages, or other debts that are part of the sale, and the fair market value of other property you receive.

If you have to sell your home because of a job transfer and your employer pays you for a loss in the value of your home, do ***not*** include the payment as part of the selling price. Include it in your gross income as compensation for services on line 7 of Form 1040.

Selling expenses include commissions, advertising, and legal fees. Loan charges paid by the seller, such as loan placement fees or "points," are usually a selling expense.

Moving expenses. You can deduct some expenses of selling your home as moving expenses. However, you cannot decrease the amount realized on the sale of your home by the real estate commission or other expenses you deduct as a moving expense. See Chapter 27.

Adjusted sales price. The adjusted sales price of the old home is used to figure the part of the gain on which tax is postponed. The adjusted sales price is the amount realized minus any fixing-up expenses you might have. Compare the adjusted sales price with the cost of the new home to find the gain on which tax is postponed.

Fixing-up expenses are decorating and repair expenses you paid to sell the old home. They must:

1) Be for work done during the 90-day period ending on the day you sign the contract to sell.
2) Be paid within 30 days after the sale.
3) Not be deductible in arriving at your taxable income.
4) Not be used in figuring the amount realized.
5) Not be capital expenses or improvements.

Note. You consider fixing-up expenses ***only*** in finding the gain on which tax is postponed. You ***cannot*** deduct them in figuring the actual profit on the sale of the old home.

Example. Your old home had a basis of $45,000. You signed a contract to sell it on December 16, 1989. On January 6, 1990, you sold it for $61,400. Selling expenses were $5,000. During the 90-day period ending December 16, 1989, you had the following work done. You paid for the work on February 1, 1990—within 30 days after the sale.

Inside and outside painting	$800
New venetian blinds and new water heater	$900

Within the required time you bought and lived in a new home that cost $54,600. The amount of gain on which tax is postponed, is not postponed, and the basis of your new home are as follows:

Gain Realized		
a) Selling price of old home	$61,400	
b) Minus: Selling expenses	5,000	
c) Amount realized on sale		$56,400
d) Basis of old home	$45,000	
e) Add: Improvements (blinds and heater)	900	
f) Adjusted basis of old home		45,900
g) Gain realized [(c) minus (f)]		$10,500
Gain Taxed in 1990		
h) Amount realized on sale	$56,400	
i) Minus: Fixing-up expenses (painting)	800	
j) Adjusted sales price		$55,600
k) Minus: Cost of new home		54,600
l) Excess of adjusted sales price over cost of new home		$ 1,000
m) Gain taxed in 1990 [lesser of (g) or (l)]		$ 1,000
Gain Not Taxed in 1990		
n) Gain realized [line (g)]	$10,500	
o) Minus: Gain taxed in 1990 [line (m)]	1,000	
p) Gain not taxed in 1990		$ 9,500
Adjusted Basis of New Home		
q) Cost of new home [line (k)]	$54,600	
r) Minus: Gain not taxed in 1990 [line (p)]	9,500	
s) Adjusted basis of new home		$45,100

Trading homes. If you trade your old home for another home, the trade is treated as a sale and a purchase.

Example. You owned and lived in a home that had a basis of $41,000. A real estate dealer accepted your old home as a trade-in and allowed you $50,000 toward a new house priced at $80,000. You are considered to have sold your old home for $50,000 and to have had a gain of $9,000 ($50,000 minus $41,000). Because you replaced it with a new home costing more than the sales price of the old one, you must postpone the tax on the gain. The basis of your new home is $71,000 ($80,000 cost minus $9,000 gain that is not currently taxed).

If the dealer had allowed you $27,000 and assumed your unpaid mortgage of $23,000 on your old home, $50,000 would still be considered the sales price of the old home (the trade-in allowed plus the mortgage assumed).

Property partly used as your home. You may use part of your property as your home and part of it for business or to produce income. Examples are a working farm on which your house is located, an apartment building in which you live in one unit and rent out the others, or a store building with an upstairs apartment in which you live. If you sell the whole property, you postpone only the tax on the part used as your home. This includes the land and outbuildings, such as a garage for the home, but not those for the business or the production of income. For more information, see *Property partly used as your home* in Publication 523.

Business use of your home. If, in the year of sale, you deduct expenses for the business use of your home, you cannot postpone the tax on the gain on the part of the home used for business. In figuring the amount of gain you can postpone, you must make an allocation for the business-use part of the home. For information on how to make the allocation, see Publication 587, *Business Use of Your Home.*

Home changed to rental property. You cannot postpone tax on the gain on rental property, even if it was once used as your home. The rules explained in this chapter generally will not apply to its sale. Gains are taxable and losses are deductible as explained in Chapter 16. The basis of the property is determined as explained under *Property Changed to Business or Rental Use* in Chapter 15.

You have not changed your home to rental property if you ***temporarily*** rent out your old home before selling it, or your new home before living in it, as a matter of convenience or for another nonbusiness purpose. You can postpone the tax on the gain from the sale if you meet the requirements explained under *Postponement of Gain.* For information on how to treat the rental income you receive, see Chapter 10.

If you place your home with a real estate agent for rent or sale and it is ***not*** rented, it will not be considered business property or property held for the production of income. The rules explained in this chapter apply to the sale of the home.

Condemnation. If your home is condemned for public use, and you have a gain, you can postpone the tax on the gain under the rules explained in this chapter or under those discussed in Publication 544, *Sales and Other Dispositions of Assets.*

Gain on casualty. The tax on a gain from a fire, storm, or other casualty cannot be postponed under the rules explained in this chapter, but may be postponed under the rules explained in Publication 547, *Nonbusiness Disasters, Casualties, and Thefts.*

New Home

The purchase price of your replacement home is used to figure the gain taxed and the gain on which tax is postponed on the sale of your old home. Purchase price includes costs incurred within the 48-month replacement period for the following items:

1) Buying or building the home.
2) Rebuilding the home.
3) Capital improvements or additions.

You cannot consider any costs incurred before or after the 48-month period. However, if you are a member of the armed forces you can include in the purchase price any costs incurred during the suspension period.

Debts on the new property. The price of a new home includes debts it is subject to when you buy it (purchase-money mortgage or deed of trust) and the face amount of notes or other liabilities you give for it.

Unstated interest. If you buy a home and the mortgage is at a low rate of interest, or no interest, a computation will be required to reflect interest at a proper rate. Generally, a computation is required if the interest rate on the mortgage is less than the applicable federal rate. For information, see Publication 537, *Installment Sales.*

Temporary housing. If a builder gives you temporary housing while your new home is being finished, you must subtract the rental value of the temporary housing from the total contract price to arrive at the cost of the new home.

Settlement fees or closing costs. When buying your home, you may have to pay settlement fees or closing costs in addition to the contract price of the property. Several expenses connected with the purchase are not included in the purchase price of the home, but are divided between the buyer and seller, according to the sales contract, local custom, or understanding of the parties.

If you itemize your deductions, you can include real estate taxes, mortgage interest, and "points" deductible as interest, in the year you buy the house. See Chapters 23 and 24. You can add other costs, such as attorneys' fees and transfer taxes, to the basis of your home. See Chapter 15.

You cannot deduct, or add to your basis, certain settlement fees or closing costs. These include "points" or loan origination fees not deductible as interest, fire insurance premiums, FHA mortgage insurance premiums, charges for the use of utilities, rent for occupancy before closing, and other fees or charges for services concerning occupancy of the house.

Investment in retirement home. You have not purchased a replacement home if you sell your home and invest the proceeds in a retirement home project that gives you living quarters, personal care, etc., but does not give

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you any legal interest in the property. Therefore, you must include in income any gain on the sale of your home. However, if you are 55 or older, see *Exclusion of Gain*, later in this chapter.

Allocation between you and your spouse. You or your spouse may have owned the old home separately, but title to the new one is in both your names as joint tenants. Or, you may have owned the old home as joint tenants and either you or your spouse owns the new home separately. In these cases the gain from the sale of the old home can be postponed. The postponed gain, which reduces the basis of the new home, can be divided between you and your spouse if both of you meet the following requirements:

1) You use the old and new homes as your main home.
2) You sign a statement that says: "We agree to reduce the basis of the new home(s) by the gain from selling the old home."

Both of you must sign the statement. The statement can be made in the bottom margin of Form 2119, *Sale of Your Home*, or on a sheet attached to your tax return. If both of you do not sign the statement, you must report the gain in the regular way without allocation.

Example 1. You sell your home which is owned separately by you, but both you and your spouse use it as your main home. The adjusted sales price is $48,000, the adjusted basis is $36,000, and the gain on the sale is $12,000. Within 2 years you and your spouse buy a new home for $50,000. You each contribute $25,000 from your separate funds and the title is held jointly. If you both sign the statement to reduce the basis of the new home, the gain on the sale will be postponed as if you had owned both the old and new homes jointly. You and your spouse will each have an adjusted basis of $19,000 ($25,000 cost minus $6,000 postponed gain) in the new home.

If you both do not sign the statement, your entire gain of $12,000 will be currently taxed because the adjusted sales price of the old home ($48,000) is greater than your part of the cost of the new home ($25,000). You and your spouse will each have a basis of $25,000 in the new home.

Example 2. Assume in Example 1 that you and your spouse owned the old home jointly, and your spouse buys the new home with separate funds and takes title individually. If you both sign the statement, the $12,000 gain from the sale of the old home will be postponed and your spouse will have an adjusted basis of $38,000 ($50,000 cost minus $12,000 postponed gain) in the new home.

If you both do not sign the statement, you will be taxed on your share of the gain on the old home, but your spouse will postpone tax on his or her share of the gain, because it was reinvested in the new home. Your spouse's basis in the new home will be $44,000 ($50,000 cost minus $6,000 postponed gain).

Example 3. Assume in Example 1 that you own the old home individually and your spouse owns the new home individually. If you both sign the statement, the gain of $12,000 from the sale of the old home will be postponed and your spouse will have an adjusted basis in the new home of $38,000.

If you both do not sign the statement, your entire gain will be taxed and your spouse's basis in the new home will be $50,000.

Deceased spouse. For sales after 1984, if your spouse dies after you sell your old home and before a new home is purchased, the tax on the gain from the sale can be postponed if the basic requirements are met, and:

1) You were married on the date your spouse died, and
2) You use the new home as your main home.

This applies whether the title of the old home is in one spouse's name or held jointly.

If you sold your home and did not postpone the entire gain on the sale because of the death of your spouse (but otherwise qualified to do so under the rules explained in this chapter), you can file an amended return (Form 1040X) to postpone the entire gain. See Chapter 1 for the time allowed to file an amended return.

Separate homes replaced by single home. The tax on your gain and your spouse's gain from the sales of homes that had been your separate main homes before your marriage will be postponed if you jointly purchase a new replacement home, and one-half the amount of the cost of the new home is at least as much as the adjusted selling prices of each of your old homes.

Each spouse must individually satisfy the requirements for postponing gain. Each spouse's share of the cost of the new home must be equal to or greater than the adjusted sales price of his or her old home.

Example. You sold your old home in April 1990, for an adjusted sales price of $90,000. Your spouse sold her old home in June of that year for an adjusted sales price of $110,000. You each realized a gain from your sales. Before the end of 1990, you jointly purchased a new replacement home at a cost of $200,000. Tax on your gain is postponed, since you are treated as purchasing a replacement home for $100,000.

There is tax on $10,000 of your spouse's gain at the time of the sale, the amount by which the adjusted sales price of her former home is more than the $100,000 cost of her replacement home.

Report the sales of the old homes on separate Forms 2119.

Title to new home not held by either you or your spouse. You ***cannot*** postpone the tax on the gain from the sale of your old home if you reinvest the proceeds from the sale in a new home in which neither you nor your spouse hold any legal interest. For example, if the title to the new home is held by someone else, such as your child, you cannot postpone the tax on the gain from the sale.

Home replaced by two homes of spouses living apart. If you and your spouse have agreed to live apart, and you each buy and live in separate replacement homes, the postponement provisions apply separately to your gain and to your spouse's gain.

Example. You and your spouse bought a home in 1984. You owned the property as tenants by the entirety and used it as your main home. In 1990, you agreed to live apart, and sold the home for $80,000. The gain on the sale was $20,000. Under state law, each of you is entitled to half the proceeds of the sale. Therefore, each of you had a $10,000 gain from the sale of your home.

Before the end of 1990, you and your spouse individually bought and lived in separate homes. The cost of each new home, $52,000 and $56,000 respectively, was more than your respective shares of the adjusted sales price of the old home. You and your spouse must postpone the tax on the $20,000 gain on the old home.

Your new home has an adjusted basis of $42,000 ($52,000 minus half of the $20,000 gain postponed). Your spouse's new home has an adjusted basis of $46,000 ($56,000 minus half of the $20,000 gain postponed).

You report the sale of your home on two Forms 2119 as if two separate properties were sold. You each report half of the sales price.

See *If you are divorced after filing a joint return*, later.

Inheritance or gift. If you receive any part of your new home as a gift or an inheritance, you cannot use the value of that part as the cost of the new home when figuring the gain on which tax is postponed. However, you include the basis of that part in your adjusted basis to determine any gain when you sell the new home.

Example. Your father died in 1990 and you inherited his home. Its basis to you is $42,000. You spent $14,000 to modernize the home, resulting in a basis to you of $56,000. Assume that within 2 years of inheriting your father's home you sell your old home for $45,000, at a gain of $5,000. You have fixing-up expenses of $200 on your old home.

To find the gain taxed in the year of the sale, you compare the adjusted sales price of the old home, $44,800 ($45,000 minus $200), with the $14,000 you invested in your new home. The $5,000 gain is fully taxed because the adjusted sales price of the old home is more than the amount you paid to rebuild your new home. You do not use the value of your inherited property ($42,000) as part of the cost of your new home.

Moving expenses. You cannot increase the basis of your new home by attorneys' fees or other expenses you deduct as moving expenses. For more information, see Chapter 27.

Holding period. If you postpone tax on any part of the gain from the sale of your old home, you will be considered to have owned your new home for the combined period you owned both the old and the new homes. See Chapter 16 for more information on holding periods.

Second sale during replacement period. If you sell your new home within 2 years after the sale of your old home, and the tax on the sale of the old home was postponed, you generally cannot postpone tax again when you sell the new home.

Example. You sold your main home in March 1989 at a gain. You postponed tax on the gain because you bought a new home in April 1989 for at least as much as the adjusted sales price of the old home. You then sell your new main home in June 1990. Even if you buy or build another new main home within 2 years, you cannot postpone tax on the June 1990 sale because it is within 2 years of the March 1989 sale.

Exception. This rule does not apply if you sell your main home because of a ***work-related move.*** A "work-related move" is one for which you are allowed a deduction for moving expenses. To qualify for the deduction, you must meet the time and distance requirements explained in Chapter 27.

If the exception applies, treat each sale as though the 2-year rule did not apply.

Example. You buy more than one new home within the two-year replacement period as shown below:

January 1990	You sell your house in **Chicago** at a gain.
February 1990	You buy a more expensive house in **Memphis.**
March 1991	You sell your house in **Memphis** due to a transfer required by your employer.
March 1991	You buy a more expensive house in **New York City.** The move meets the requirements for a moving expense deduction.

When you complete the 1990 Form 2119 for the sale of your house in Chicago, compare the cost of the home bought in Memphis with the adjusted sales price of the house in Chicago, even though you bought another new main home within two years (New York City in March 1991).

Your 1991 Form 2119 will compare the adjusted sales price of the house in Memphis (sold March 1991) with the cost of the house in New York City.

More than one new home. If you buy or build more than one main home during the replacement period, only the last one bought or built in the period can be treated as the ***new home*** to determine whether you can postpone the tax on the gain from the sale of the old home.

Example. You sold your old main home on March 15, 1989, at a gain. You bought a new main home on June 3, 1989. On February 3, 1990, you bought another new main home and converted the home bought June 3, 1989, to rental property. In figuring whether you can postpone tax on the gain on your old home, compare the cost of the new home you bought on February 3, 1990, with the adjusted sales price of the old home sold on March 15, 1989.

Exception. If you buy more than one new home within the replacement period because of a work-related move, this rule does not apply. See *Exception*, in *Second sale during replacement period*, earlier.

Continued postponement of gain. If you bought your present home in a way that lets you postpone tax, you continue to postpone the tax if you replace your present home under the rules explained in this chapter.

Example. In 1975 you sold your home, which you had owned since 1965, and bought a new one. The tax on the gain was postponed and the basis of the home you bought in 1975 was reduced by the gain you postponed. This year you sold the home you bought in 1975 and bought a more expensive one. You can postpone tax on the gain from selling the home you bought in 1975.

How to Report

If you sold your home during the year, report the details of the sale as explained here, even if the tax is postponed on the entire gain or you have not purchased a new home.

Report on Form 2119 in year sold. Use Form 2119, *Sale of Your Home*, to report the sale of your old home and any purchase of a new one. See Chapter 38 for an example of a filled-in Form 2119.

You should keep a copy of Form 2119 with your tax records for the year for future proof of your basis in the replacement home.

Before return for year of sale filed. If you buy a new home before you file a return for the year of sale of your old home and it costs as much or more than the adjusted sales price of the old home, complete Form 2119 and attach it to your return. Show the price of the new home, the date you first lived in it, how you figured the gain on which tax is postponed, and the adjusted basis of your new home.

If the new home costs less than the adjusted sales price of the old home, you must complete Form 2119 and attach it to your return. Show the gain reported this year on Schedule D.

After return for year of sale filed and within replacement period. If you plan to replace your home, but have not done so by the time your return is due, you must report the sale on Form 2119 and attach it to your return for the year of the sale. Complete Part I and Part II only. When you buy and live in your new home within the replacement period, and it costs as much or more than the adjusted sales price of the old home, you should notify the Director of the Internal Revenue Service Center where you would file your next tax return based on the address where you live. You notify the IRS by filing a second Form 2119 giving the date you first lived in the new home and its cost. Your address, signature, and the date are required on this Form 2119 if you do not file the form with a tax return. If a joint return was filed for the year of sale, you and your spouse must sign it.

If the new home costs less than the adjusted sales price of the old home, and you buy and live in the house within the replacement period, you must file an amended return (Form 1040X) for the year of the sale. Attach a second completed Form 2119 and Schedule D showing the gain you must report. You will have to pay interest on any additional tax due on the amended return.

Old home not replaced or new home not purchased within replacement period. If you do not plan to replace your old home, you must complete Form 2119 and Schedule D to report any gain and attach them to your tax return for the year of the sale. The entire gain is taxable unless you are eligible to exclude all or part of the gain. See *Exclusion of Gain*, later.

If you postponed tax on the gain on the sale of your old home and do not buy or build and live in a new home within the replacement period, you must file a second Form 2119 and an amended return (Form 1040X) for the year of the sale. Include a Schedule D to report your gain, and any other appropriate schedule. For example, you would have to include Form 6252 to report an installment sale. You will have to pay interest on the additional tax due on your amended return.

If you are divorced after filing a joint return on which you postponed tax on the gain on the sale of your home, but you do not use your share of the proceeds to buy or build a new home (and your former spouse does), you must file an amended joint return to report the tax on your share of the gain. If your former spouse refuses to sign the amended joint return, attach a letter explaining why your former spouse's signature is missing.

If you paid tax on the gain from the sale of your old home, and you buy or build and live in a new home within the replacement period, you should file an amended return (Form 1040X) for the year of sale of your old home. Complete a new Form 2119, and include it with your amended return. Report on Schedule D any gain on which you cannot postpone the tax, and claim a refund of the rest of the tax.

How to Report the Sale of Your Home

New Home Purchased and Occupied Within Replacement Period		
When New Home Purchased:	New Home Cost EQUAL or GREATER Than Adjusted Sales Price of Old Home	New Home Cost LESS Than Adjusted Sales Price of Old Home
BEFORE Return filed for year of sale	Attach completed Form 2119 to return.	Attach completed Form 2119 and Schedule D to return.
AFTER Return filed for year of sale	Report sale by attaching Form 2119 to return for year of sale. When new home purchased and occupied:	
	Send second Form 2119 to IRS Center where next return to be filed.	File 1040X for year of sale. Attach second Form 2119 and Schedule D.

New Home NOT Purchased and Occupied Within Replacement Period	
When Return Filed for Year of Sale:	Action
Do Not Plan to Replace Old Home	Attach completed Form 2119 to return for year of sale. Attach Schedule D to report gain on sale.
Plan to Replace Old Home	Report sale by attaching Form 2119 to return for year of sale.
	When new home not purchased and occupied within replacement period, file Form 1040X for year of sale. Attach second Form 2119. Attach Schedule D to report gain on sale.

Installment sale. You can report on the installment basis the part of the gain you cannot postpone if the sale qualifies as an installment sale. See Publication 537.

Statute of limitations. The 3-year limit for assessing tax on the gain from the sale of your home begins when you notify the IRS that you replaced the home, you do not intend to replace the home, or you did not replace the home in time to postpone the tax on the gain. This information may be on the Form 2119 attached to your tax return for the year of the sale, or, if not, you must file a second Form 2119 showing one of the following:

1) You replaced your old home, and how much the replacement home cost.
2) You do not plan to buy a new home within the replacement period.
3) You did not buy a new home within the replacement period.

File the second Form 2119 with the Service Center where you will file your next tax return. If needed, send an amended return for the year of the sale to include in income the gain on which tax cannot be postponed.

Real Estate Transactions

The law requires that transactions involving the sale of most residential real estate property be reported to the IRS by filing Form 1099–S, *Statement for Recipients of Proceeds From Real Estate Transactions.* Real estate brokers are prohibited from charging any customer separately for preparing Form 1099–S.

Exclusion of Gain

You can exclude from gross income all or part of the gain from the sale of your main home, if you meet certain age, ownership, and use tests at the time of the sale. You can choose to exclude gain only once for sales after July 26, 1978.

Age, Ownership, and Use

You can choose to exclude from income $125,000 of gain on the sale of your main home ($62,500 if you are married on the date of sale and file separate returns) if you meet ***all*** the following requirements:

1) You were 55 or older on the date of the sale.
2) You ***owned and lived in*** your main home for at least 3 years out of the 5-year period ending on the date of the sale.
3) Neither you nor your spouse has excluded gain on the sale of a home since July 26, 1978.

For more information and examples, see *Exclusion of Gain* in Publication 523.

18. Reporting Gains and Losses

This chapter discusses reporting capital gains and losses from sales, exchanges, and other dispositions of investment property. It covers the use of Schedule D (Form 1040) for figuring your net capital gain income or your deductible capital loss. For information on reporting sales of business property, see Publication 544, *Sales and Other Dispositions of Assets.*

Caution: As this publication was being prepared for print, Congress was considering a proposal that may change the way you figure long-term capital gains for 1990. For further information on any late legislative changes, get Publication 553, *Highlights of 1990 Tax Changes.*

Schedule D

Report capital gains and losses on Schedule D (Form 1040), *Capital Gains and Losses.* This schedule is also used to figure the limit on capital losses and to reconcile your Forms 1099–B, as discussed later. Use Schedule D–1 as a continuation schedule to report additional transactions.

Passive activity gains and losses may also have to be reported on **Form 8582,** *Passive Activity Loss Limitations.* In some cases, the loss may be limited under the passive activity rules. Refer to Form 8582 and its separate instructions for more information about reporting capital gains and losses from a passive activity.

Form 1099–B transactions. If you sold property, such as securities, commodities, bonds, etc., through a broker, you should receive Form 1099–B, *Statement for Recipients of Proceeds From Broker and Barter Exchange Transactions,* or an equivalent statement from the broker. Use the Form 1099–B or equivalent statement to complete line 1 of Schedule D (Form 1040).

Report the gross proceeds shown in Box 2 of Form 1099–B as the gross sales price in column (d) of either line 2a or line 9a of Schedule D, as applicable. However, if the broker advises you, in Box 2 of Form 1099–B, that gross proceeds (gross sales price) less commissions and option premiums were reported to the IRS, enter that ***net sales price*** in column (d) of either line 2a or line 9a of Schedule D, as applicable. If the net amount is entered in column (d), do not include the commissions and option premiums in column (e). Be sure to add all sales price entries in column (d) on lines 2a and b and lines 9a and b and enter the totals on lines 2c and 9c. If line 1 differs from the total of lines 2c and 9c, column (d), attach a statement to your return explaining why.

If the Form 1099–B you receive includes amounts derived from the sale or exchange of section 1256 contracts or straddles, or from hedging transactions, see Publication 550, *Investment Income and Expenses,* for more information about reporting these amounts.

Form 1099–S transactions. If you sold or exchanged one-to-four-family real estate, you should receive Form 1099–S, *Statement for Recipients of Proceeds From Real Estate Transactions,* from the settlement agent. One-to-four-family real estate is a structure designed for the occupancy of up to four families, such as a house, townhouse, duplex, or four-unit apartment building. It can include stock in a cooperative housing corporation.

The gross proceeds from the sale or exchange are shown in Box 2 of Form 1099–S. Follow the Schedule D instructions for reporting these transactions and include them on line 2a or 9a as appropriate. Also use Form 1099–S to complete line 1 of Schedule D.

If the building sold or exchanged was your principal residence, report the sale on **Form 2119,** *Sale of Your Home.* Do not include the proceeds from this sale on line 1 of Schedule D.

It is unlawful for any real estate reporting person to separately charge you for complying with the real estate information-reporting requirements.

Other transactions. Enter all sales of stocks, bonds, real estate (other than the sale of your main home), etc., on line 2a or line 9a of Schedule D (Form 1040) as applicable, whether or not you actually received a Form 1099–B or Form 1099–S. Use either line 2d or line 9d of Schedule D, as applicable, to report gains and losses on other transactions.

If you had gains or losses from the disposition of ***options,*** including puts and calls, see *Options* under *Capital or Ordinary Gain or Loss* in Publication 550.

Sale expenses. Add to your cost or basis any expense of sale such as broker's fees, commissions, state and local transfer taxes, and option premiums. Enter this adjusted amount in column (e) of either Part I or Part II of Schedule D (Form 1040), as applicable, unless you reported the net sales price amount in column (d).

For more information about adjustments to basis, see Chapter 15.

Short-term gains and losses. Gain or loss on the sale or trade of investment property held one year or less is a short-term capital gain or loss. Report it in Part I of Schedule D (Form 1040).

You combine your share of short-term capital gains or losses from partnerships, S corporations, or fiduciaries, and any short-term capital loss carryover, with your other short-term gains and losses to figure your net short-term capital gain or loss on line 8 of Schedule D (Form 1040).

Property held for personal use. Gain on the sale or exchange of property held for personal use and held for one year or less is a short-term capital gain. Report it in Part I of Schedule D (Form 1040). Losses on sales or exchanges of property held for personal use are not deductible.

Long-term gains and losses. A gain or loss on the sale or trade of investment property held more than one year is a long-term capital gain or loss. Report it in Part II of Schedule D (Form 1040).

You also report the following in Part II of Schedule D (Form 1040):

1) All capital gain distributions from regulated investment companies (mutual funds) and real estate investment trusts.

2) Your share of long-term capital gains or losses from partnerships, S corporations, and fiduciaries.

3) Long-term capital loss carryovers.

The result from combining these items with your other long-term gains and losses is your net long-term capital gain or loss (line 17 of Schedule D (Form 1040)).

Property held for personal use. Gain on the sale or exchange of property held for personal use and held more than one year is a long-term capital gain. Report it in Part II of Schedule D (Form 1040). Loss on the sale or exchange of property held for personal use is not deductible.

Capital gain distributions. You report capital gain distributions on line 13, Part II of Schedule D (Form 1040) regardless of how long you have held your investment. If you do not need Schedule D to report any other capital gains or losses, enter your capital gain distributions for 1990 on line 14, Form 1040.

The total net gain or loss is then figured by combining your net short-term capital gain or loss (line 8) with your net long-term capital gain or loss (line 17). Enter the result on line 18, Part III of Schedule D. If your losses are more than your gains, see *Capital Losses*, next.

Capital Losses

If you have a total net capital loss, you can claim a capital loss deduction. You must first figure how much of the loss is allowable. Then you must figure how much of the loss you may deduct in the year of the loss and how much of it you carry over and use in future tax years.

Figuring your loss. If your capital losses are more than your capital gains, up to $3,000 of the excess loss is allowed.

If you have both short-term and long-term items, figure your capital loss as follows:

1) If you had a net short-term capital loss and a net long-term capital gain, your short-term loss is your net short-term capital loss minus your net long-term capital gain.

2) If you had a net long-term capital loss and a net short-term capital gain, subtract your net short-term capital gain from your net long-term capital loss. This is your long-term capital loss.

Yearly limit. Your allowable capital loss deduction for any tax year is limited to the lesser of:

1) $3,000 ($1,500 if you are married and file a separate return), or

2) Your capital loss, as shown on line 18 of Schedule D.

Capital loss carryover. If your capital loss is more than the yearly limit, you may carry over the unused part to the next tax year and treat it as if it occurred in that year. When a loss is carried over, it retains its original character as long term or short term. A short-term loss that is carried over to the next tax year is added to short-term losses that occur in that year. A long-term loss that is carried over to the next tax year is added to long-term losses that occur in that year.

You can carry over a capital loss that is more than the amount of allowable loss to the next year and treat it as if you had incurred it in that year. When you figure the amount of any capital loss carryover in a later tax year, you must take into account any deductions for capital losses allowed in earlier years.

Figuring the carryover. When figuring how much of your capital loss you may carry over as short term and how much as long term, use your short-term losses first, even if you incurred them after a long-term loss. If you have not reached the limit on the capital loss deduction after using the short-term loss, use the long-term losses until you reach the limit.

The amount of your capital loss carryover is the amount of your capital loss that exceeds the lesser of:

1) Your allowable capital loss deduction for the year, or

2) Your taxable income increased by your allowable capital loss deduction for the year and your deduction for personal exemptions.

If your deductions exceed your gross income for the tax year, use your negative taxable income in computing the amount in item (2).

Example. Bob and Gloria sold securities in 1990. The sales resulted in a capital loss of $7,000. They had no other capital transactions. On their joint 1990 return, they can deduct $3,000. The unused part of the loss, $4,000 ($7,000 – $3,000), can be carried over to 1991.

If their capital loss had been $2,000, their capital loss deduction would have been $2,000. They would have no carryover to 1991.

Joint and separate returns. If you are married and filing a separate return, your yearly capital loss deduction is limited to $1,500. Neither you nor your spouse may deduct any part of the other's loss.

If you and your spouse once filed separate returns and are now filing a joint return, you must combine each of your capital loss carryovers. However, if you and your spouse once filed a joint return and are now filing separately, any capital loss carryover can be deducted only on the return of the person who actually had the loss.

A decedent's capital loss. Capital losses cannot be carried over after a taxpayer's death. They are deductible only on the final income tax return filed for the decedent. The capital loss limits discussed earlier still apply in this situation. This loss may not be deducted by the decedent's estate or carried over to following years.

Figuring your capital loss carryover. Complete Part IV of Schedule D (Form 1040) to determine the part of your capital loss for 1990 that you can carry over to 1991.

Comprehensive Example

Jane Smith is single and, in addition to her regular employment, she has income from some stocks and other securities. For the 1990 tax year, she had the following capital gains and losses, which she reports on Schedule D. Her filled-in Schedule D is shown in this chapter.

Capital gains and losses — Schedule D. Jane sold stock in two different companies that she held for short term. In June, she sold 100 shares of Bates Trucking Co. common stock that she had purchased in May. She had an adjusted basis of $650 in the Bates stock and sold it for $900, for a gain of $250. In June, she sold 25 shares of Alpha Computing preferred stock that she bought in March. She had an adjusted basis in the Alpha stock of $2,500 and she sold this stock for $2,000, for a loss of $500. These short-term transactions are reported in Part I of Schedule D.

During the year, Jane sold securities she had held for long term in two corporations. In February, she sold 60 shares of Car Motor Co. for $2,100. She had inherited the Car stock from her father. Its fair market value at the time of his death was $700, which became her basis. Her gain on the sale, therefore, was $1,400.

Jane had a basis of $34,000 in 500 shares of Weeping Willow Furniture Co. nonconvertible preferred stock that she bought on June 25, 1987. On June 29, 1990, she sold this stock for $4,100. She realized a $29,900 loss on this sale.

The long-term capital transactions are entered in Part II of Schedule D.

Capital loss carryover — Schedule D. Jane has a capital loss carryover to 1990 of $800, of which $300 is short-term capital loss, and $500 is long-term capital loss.

Jane kept a copy of her 1989 Form 1040, Schedule D, so she could properly report her loss carryover for the 1990 tax year without refiguring it.

Reconciliation of Forms 1099–B. Jane completes line 1 and Part I and Part II of Schedule D (Form 1040) to reconcile and summarize the amounts reported on Schedule D from the sales of various stocks with the amounts shown on the Forms 1099–B she received from her stockbroker. For 1990, the total of her stock sales is $9,100. Jane reports this amount on line 1 of Schedule D. The total of column (d) on line 2c and line 9c equals the amount shown on line 1 of Schedule D.

Page 100 Chapter 18

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

(And Reconciliation of Forms 1099-B for Bartering Transactions)

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).
▶ For more space to list transactions for lines 2a and 9a, get Schedule D-1 (Form 1040).

OMB No. 1545-0074

1990

Attachment Sequence No. 12A

Name(s) shown on Form 1040: Jane Smith

Your social security number: 458 00 0327

1 Enter the total sales of stocks, bonds, other securities, and real estate transactions reported to you for 1990 on Forms 1099-B and 1099-S (or on substitute statements). If this total is not the same as the total of lines 2c and 9c, column (d), attach a statement explaining the difference. (Do not include on the line amounts from Form 1099-S if you reported them on another form or schedule.) See Instructions for line 1 . . . 1 9,100 00

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see instructions)	(e) Cost or other basis (see instructions)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
2a Stocks, Bonds, Other Securities, and Real Estate. Include Form 1099-B and 1099-S Transactions. See Instructions.						
100 shares Motor Trucking Co.	5-11-90	6-29-90	900 —	650 —		250 00
25 shares Alpha Computing	3-9-90	6-29-90	2,000 —	2,500 —	500 00	
2b Amounts from Schedule D-1, line 2b (attach Schedule D-1)						
2c Total of All Sales Price Amounts. Add column (d) of lines 2a and 2b ▶ 2c			2,900 00			
2d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 2a.)						
3 Short-term gain from sale or exchange of your home from Form 2119, line 10 or 14c					3	
4 Short-term gain from installment sales from Form 6252, line 22 or 30					4	
5 Net short-term gain or (loss) from partnerships, S corporations, and fiduciaries					5	
6 Short-term capital loss carryover from 1989 Schedule D, line 29					6 300 00	
7 Add lines 2a, 2b, 2d, and 3 through 6, in columns (f) and (g)					7 (800 00)	250 00
8 Net short-term gain or (loss). Combine columns (f) and (g) of line 7						8 (550 00)

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see instructions)	(e) Cost or other basis (see instructions)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
9a Stocks, Bonds, Other Securities, and Real Estate. Include Form 1099-B and 1099-S Transactions. See Instructions.						
40 shares Cee Marker Co.	Inherited	2-13-90	2,100 —	700 —		1,400 00
500 shares Weeping Willow Furniture Co.	6-25-87	6-29-90	9,100 —	34,000 —	24,900 00	
9b Amounts from Schedule D-1, line 9b (attach Schedule D-1)						
9c Total of All Sales Price Amounts. Add column (d) of lines 9a and 9b ▶ 9c			6,200 00			
9d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 9a.)						
10 Long-term gain from sale or exchange of your home from Form 2119, line 10 or 14c					10	
11 Long-term gain from installment sales from Form 6252, line 22 or 30					11	
12 Net long-term gain or (loss) from partnerships, S corporations, and fiduciaries					12	
13 Capital gain distributions					13	
14 Gain from Form 4797, line 7 or 9					14	
15 Long-term capital loss carryover from 1989 Schedule D, line 36					15 500 00	
16 Add lines 9a, 9b, 9d, and 10 through 15, in columns (f) and (g)					16 (30,400 00)	1,400 00
17 Net long-term gain or (loss). Combine columns (f) and (g) of line 16						17 (29,000 00)

For Paperwork Reduction Act Notice, see Form 1040 Instructions

Schedule D (Form 1040) 1990

Schedule D (Form 1040) 1990 Attachment Sequence No. 12A Page 2

Name(s) shown on Form 1040 (Do not enter name and social security number if shown on other side.) Your social security number

Part III Summary of Parts I and II

18 Combine lines 8 and 17, and enter the net gain or (loss) here. If the result is a gain, stop here and also enter the gain on Form 1040, line 13	18	(29,550 00)
19 If line 18 is a (loss), enter here and as a (loss) on Form 1040, line 13, the smaller of:		
a The (loss) on line 18; or		
b ($3,000) or, if married filing a separate return, ($1,500)	19	(3,000 —)
Note: When figuring whether line 19a or 19b is smaller, treat both numbers as if they were positive. Go on to Part IV if the loss on line 18 is more than $3,000 ($1,500, if married filing a separate return). OR if taxable income on Form 1040, line 37, is zero.		

Part IV Capital Loss Carryovers from 1990 to 1991

Section A.—Carryover Limit

20 Enter taxable income from Form 1040, line 37. (If Form 1040, line 37 is zero, see Instructions for amount to enter.)	20	34,580 00
Note: For lines 21 through 36, enter all amounts as positive numbers.		
21 Enter the loss on line 19	21	3,000 00
22 Enter the amount on Form 1040, line 36	22	2,050 00
23 Combine lines 20, 21, and 22. If zero or less, enter -0-	23	34,630 00
24 Carryover Limit. Enter the smaller of line 21 or line 23	24	3,000 00

Section B.—Short-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on both line 8 and line 19. Otherwise, go on to Section C.)

25 Enter the loss on line 8		25	550 00
26 Enter the gain, if any, on line 17	26 -0-		
27 Enter the amount on line 24	27 3,000 00		
28 Add lines 26 and 27		28	3,000 00
29 Short-term capital loss carryover to 1991. Subtract line 28 from line 25. If zero or less, enter -0-		29	-0-

Section C.—Long-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on both line 17 and line 19.)

30 Enter the loss on line 17		30	29,000 00
31 Enter the gain, if any, on line 8		31	-0-
32 Enter the amount on line 24	32 3,000 00		
33 Enter the amount, if any, on line 25	33 550 00		
34 Subtract line 33 from line 32. If zero or less, enter -0-		34	2,450 00
35 Add lines 31 and 34		35	2,450 00
36 Long-term capital loss carryover to 1991. Subtract line 35 from line 30. If zero or less, enter -0-		36	26,550 00

Part V Election Not to Use the Installment Method (Complete this part only if you elect out of the installment method and report a note or other obligation at less than full face value.)

37 Check here if you elect out of the installment method	▶ ☐
38 Enter the face amount of the note or other obligation	▶
39 Enter the percentage of valuation of the note or other obligation	▶

Part VI Reconciliation of Forms 1099-B for Bartering Transactions

(Complete this part if you received one or more Forms 1099-B or substitute statements reporting bartering income.)

		Amount of bartering income from Form 1099-B or substitute statement reported on form or schedule
40 Form 1040, line 22	40	
41 Schedule C (Form 1040)	41	
42 Schedule D (Form 1040)	42	
43 Schedule E (Form 1040)	43	
44 Schedule F (Form 1040)	44	
45 Other form or schedule (identify) (If nontaxable, indicate reason—attach additional sheets if necessary):	45	
46 Total (add lines 40 through 45)	46	

Note: The amount on line 46 should be the same as the total bartering income on all Forms 1099-B and substitute statements received for bartering transactions.

Part IV
Adjustments to Income

There are two main groups of deductions you can take on your tax return:

1) Those that are used to figure adjusted gross income, and

2) Those that are subtracted from adjusted gross income to figure taxable income.

The chapters in this part discuss two of the deductions in the first group. They are the deduction for alimony you pay and the deduction for payments to an individual retirement arrangement (IRA). Other deductions in the first group are the deductions for self-employment tax (see Chapter 23 of Part V), for self-employed health insurance (see Chapter 22 of Part V), for payments to a Keogh retirement plan or self-employed SEP (see Publication 560, *Retirement Plans for the Self-Employed*), and for a penalty on early withdrawal of savings (see Chapter 8 of Part II).

You can also write in certain deductions in figuring adjusted gross income on Form 1040. These write-in deductions are limited to the following:

- **Certain expenses of qualified performing artists (see Chapter 28 of Part V),**
- **Jury duty pay given to your employer (see Chapter 13 of Part II),**
- **Foreign housing deduction (see Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*),**
- **Amortization of the costs of forestation or reforestation (see Publication 535, *Business Expenses*), and**
- **Certain required repayments of supplemental unemployment benefits (see Chapter 6 of Part II).**

19. Individual Retirement Arrangements (IRAs)

An individual retirement arrangement (IRA) is a personal savings plan that offers you tax advantages to set aside money for your retirement. That means that you may be able to deduct your contributions to your IRA in whole or in part, depending on your circumstances, and that, generally, amounts in your IRA, including earnings and gains, are not taxed until they are distributed to you.

Note. Although interest earned from your IRA is generally not taxed in the year earned, it is not ***tax-exempt*** interest. Do not report this interest on your tax return as ***tax exempt.***

The discussion on IRAs in this chapter provides basic information. For more information, get Publication 590, *Individual Retirement Arrangements (IRAs).*

If you work for yourself, you may be able to deduct contributions to a Simplified Employee Pension (SEP) that involves the use of IRAs (SEP-IRAs). You may also be able to deduct contributions to other retirement plans for the self-employed (sometimes called Keogh or HR–10 plans). Only self-employed individuals may deduct such contributions. For details, get Publication 560, *Retirement Plans for the Self-Employed.*

Who Can Set Up an IRA?

You can set up and make contributions to an IRA if you received taxable ***compensation*** during the year and have not reached age 70½ by the end of the year.

Compensation includes wages, salaries, commissions, tips, professional fees, bonuses, and other amounts you receive for providing personal services. It also includes taxable alimony and separate maintenance payments.

If you are self-employed, compensation is your net earnings from your trade or business (provided your personal services are a material income-producing factor), reduced by your deduction for contributions on your behalf to self-employed retirement plans. Compensation includes earnings that are not subject to self-employment (Self-Employed Contributions Act) tax because of your religious beliefs. When figuring your net earnings, take into account the deduction allowed for one-half of your self-employment taxes. See Publication 533, *Self-Employment Tax* , for more information.

Compensation does ***not*** include:

- Earnings and profits from property, such as rental income, interest income, and dividend income,
- Pension or annuity income,
- Deferred compensation,
- Foreign earned income and/or housing cost amounts that are excluded from gross income, or
- Any other amounts that are excluded from income.

How Can an IRA Be Set Up?

You can set up different kinds of IRAs with a variety of organizations. You can set up an IRA at a bank or other financial institution, or with a mutual fund or life insurance company. You can even set up an IRA through your stockbroker. Any plan must meet Internal Revenue Code requirements.

IRA for your spouse. You may be eligible to set up and contribute to (see *How Much Can I Contribute and Deduct*, later) an IRA for your spouse, whether or not he or she received compensation. This is called a *spousal IRA* and is generally set up for a nonworking spouse.

Eligibility requirements. To contribute to a spousal IRA:

You must be married at the end of the tax year,

Your spouse must be under age 70½ at the end of the tax year,

You must file a joint return for the tax year,

You must have taxable compensation for the tax year, and

Your spouse must either have no compensation or choose to be treated as having no compensation for the tax year.

Kinds of IRAs. Your IRA can be an individual retirement account or annuity. It can be either a part of a simplified employee pension (SEP) or a part of an employer or employee association trust account.

How Much Can I Contribute and Deduct?

Contributions to an IRA must be in the form of money (cash, check, or money order). ***You cannot contribute property.*** However, you may be able to roll over or transfer certain property from one IRA to another. See the discussion under *Rollovers* in Publication 590.

Contribution Limits

The most that you can contribute for any year to your IRA is ***the smaller of*** the following amounts:

1) Your compensation (defined earlier) that you must include in income for the year, or

2) $2,000.

This is the most you can contribute regardless of whether your contributions are to one or more IRAs or whether all or part of your contributions are nondeductible.

Example 1. Betty, who is single, earns $24,000 in 1990. Her IRA contributions are limited to $2,000.

Example 2. John, a college student working part-time, earns $1,500 in 1990. His

IRA contributions for 1990 are limited to $1,500, the amount of his compensation.

Spousal IRA. The total combined contributions you can make each year to your IRA and a spousal IRA (discussed earlier) is ***the smaller of:***

1) Your taxable compensation for the year, or
2) $2,250.

You can divide your IRA contributions between your IRA and the spousal IRA any way you choose, as long as you do not contribute more than $2,000 to either IRA.

Spouse has compensation during the year. If your spouse also has taxable compensation during the year, you and your spouse can each have regular IRAs. You each can contribute up to the $2,000 limit, unless your taxable compensation (or your spouse's) is less than $2,000.

However, you or your spouse can choose to be treated as having no compensation for the year and use the rules for spousal IRAs. Generally, if one spouse has compensation of less than $250 for the year, a spousal IRA is more advantageous than a regular IRA.

Example 1. Bill and Linda file a joint return for 1990. Bill earned $27,000 and Linda earned $190. Linda chose to be treated as having no compensation; therefore, Bill set up a spousal IRA for her. For 1990, he contributed $1,800 to his IRA. He can contribute up to $450 ($2,250 minus $1,800) to the spousal IRA.

Example 2. Assume the same facts as in example 1 except that Bill's contribution to the spousal IRA is $2,000 (the limit for either IRA). The most he can contribute to his own IRA is $250 ($2,250 minus $2,000).

Spouse under age 70½. Although you cannot make contributions to your IRA for the year you reach age 70½ or any later year, you can continue to make contributions to a spousal IRA until the year your spouse reaches age 70½.

Contributions not required. You are not required to make contributions to your IRA or a spousal IRA for every tax year, even if you can.

If you and your spouse each contribute to an IRA, the contribution limit for each of you is figured separately.

IRA contributions under community property laws. If you work and have an IRA, contributions cannot be made to your IRA based on the earnings of your spouse, unless you have a spousal IRA. The contributions must be based on your own compensation, even in community property states.

Inherited IRAs. If you inherited an IRA from someone who died after December 31, 1983, and you were not the decedent's spouse, you will not be allowed to contribute to that inherited IRA.

When To Contribute

You can make contributions to your IRA (or to a spousal IRA) for a year at any time during the year or by the due date of your return for that year, ***not*** including extensions. For most people, this means that contributions for 1990 must be made by April 15, 1991.

Designating year for which contribution is made. If you contribute an amount to your IRA between January 1, 1991, and April 15, 1991, tell the sponsor (the trustee or issuer) which year (1990 or 1991) the contribution is for. If you do not tell the sponsor which year it is for, the sponsor may assume, for reporting to IRS, that the contribution is for 1991, the year the sponsor received it.

Filing before making your contribution. You can file your return claiming an IRA contribution before you actually make the contribution. You must, however, make the contribution by the due date of your return, ***not*** including extensions.

Deductible Contributions

Generally, you can take a deduction for the contributions that you are allowed to make to your IRA. However, if you or your spouse is covered by an employer retirement plan at any time during the year, your IRA deduction may be reduced or eliminated depending on your filing status and the amount of your income.

Who Is Covered by an Employer Plan?

The **Form W-2,** *Wage and Tax Statement,* you receive at the end of the year from your employer includes a box to indicate whether or not you are covered for the year. The form should have a check in the "Pension Plan" box if you are covered.

You are also covered by a plan if you are self-employed and participate in a qualified retirement plan (such as a Keogh plan) or a simplified employee pension (SEP) plan.

If you are not certain whether you are covered by your employer's retirement plan, you should ask your employer.

Employer Plans

An employer retirement plan is one that an employer sets up for the benefit of the employees. For purposes of the IRA deduction rules,

CAN YOU TAKE AN IRA DEDUCTION?

This chart sums up whether you can take a full deduction, a partial deduction, or no deduction as discussed in this chapter.

If Your Modified AGI* is		If You Are Covered by a Retirement Plan at Work and Your Filing Status is			If You Are Not Covered by a Retirement Plan at Work and Your Filing Status is			
		• Single • Head of Household	• Married Filing Jointly (even if your spouse is not covered by a plan at work) • Qualifying Widow(er)	Married Filing Separately**	Married Filing Jointly (and your spouse is covered by a plan at work)	• Single • Head of Household	• Married Filing Jointly or Separately (and your spouse is not covered by a plan at work) • Qualifying Widow(er)	Married Filing Separately (even if your spouse is covered by a plan at work)***
At Least	But Less Than	You Can Take	You Can Take	You Can Take	You Can Take	You Can Take	You Can Take	You Can Take
$-0-	$10,000	Full deduction	Full deduction	Partial deduction	Full deduction			
$10,000	$25,000	Full deduction	Full deduction	No deduction	Full deduction			
$25,000	$35,000	Partial deduction	Full deduction	No deduction	Full deduction	Full Deduction	Full Deduction	Full Deduction
$35,000	$40,000	No deduction	Full deduction	No deduction	Full deduction			
$40,000	$50,000	No deduction	Partial deduction	No deduction	Partial deduction			
$50,000 or over		No deduction	No deduction	No deduction	No deduction			

***Modified AGI** (adjusted gross income) is: (1) for Form 1040A—the amount on line 14, or (2) for Form 1040—the amount on line 31, figured without taking into account any IRA deduction or any foreign earned income exclusion and foreign housing exclusion (deduction).

**If you did not live with your spouse at any time during the year, your filing status is considered, for this purpose, as Single (therefore your IRA deduction is determined under the "Single" column).

***You are entitled to the full deduction only if you did not live with your spouse at any time during the year. If you did live with your spouse during the year, you are, for this purpose, treated as though you are covered by a retirement plan at work (therefore, your IRA deduction is determined under the "Married Filing Separately" column in the "If You Are Covered by a Retirement Plan..." section of the chart).

an employer retirement plan is any of the following:

- A qualified (meets Internal Revenue Code requirements) pension, profit-sharing, stock bonus, money purchase, etc., plan (including Keogh plans),
- A 401(k) plan (generally a profit-sharing or stock bonus plan to which contributions can be made under an arrangement allowing you to choose to take your income in cash or have your employer pay it into the plan),
- A union plan (a qualified stock bonus, pension, or profit-sharing plan created by a collective bargaining agreement between employee representatives and one or more employers),
- A qualified annuity plan,
- A plan established for employees by a federal, state, or local government, or any of their political subdivisions, agencies, or instrumentalities (other than an eligible state deferred compensation plan),
- A tax-sheltered annuity plan for employees of public schools and certain tax-exempt organizations (403(b) plan),
- A simplified employee pension (SEP) plan, or
- A 501(c)(18) trust (a certain type of tax-exempt trust created before June 25, 1959, that is funded only by employee contributions).

Effects of marital status. You may be considered covered by an employer retirement plan because your spouse is covered by one. To determine whether you are considered covered for the year because of your spouse, you must wait until the last day of the year. This is because whether you are considered married or single for the year depends on your filing status on the last day of the tax year.

If you were married to two different spouses during the same year, you are considered married for the year, for this purpose, to the spouse to whom you were married at the end of the year.

If your spouse died during the year, and you file a joint return as the surviving spouse, coverage by an employer retirement plan for that year is determined as if your spouse were still alive.

If you are married filing a joint return. Both you and your spouse are considered covered by a plan if either of you is covered by a plan and you file a joint return.

If you are married filing a separate return and you are not covered by an employer retirement plan, but your spouse is, you are considered covered if you and your spouse lived together at any time during the year.

Nonvested employees. If your employer sets aside money under a plan during the year for your retirement, you are considered covered by a plan that year. It does not matter that you are not yet vested (given a legal right to the money).

Federal judges are considered covered by an employer retirement plan for figuring the IRA deduction.

When Are You Not Covered?

You are not covered by an employer plan if neither you nor your spouse is covered for any part of the year. You are also not covered for this purpose in the following situations.

If you are married filing a separate return and you are not covered by an employer retirement plan, you can be considered not covered, even if your spouse is covered by a plan. This rule applies only if you and your spouse did not live together at any time during the year.

Coverage under social security or railroad retirement does not count as coverage under an employer retirement plan for figuring the IRA deduction.

If you receive retirement benefits from a previous employer's plan, you are not considered covered by that plan for this purpose.

Reservists and volunteer firefighters. Certain members of the reserve units of the Armed Forces (in general, those members who did not serve in excess of 90 days during the year) and certain volunteer firefighters (in general, those members whose accrued retirement benefit at the beginning of the year will not exceed $1,800 per year at retirement) are not considered covered by U.S. or local government retirement plans.

Social Security Recipients

If you receive social security benefits, have taxable compensation, contribute to your IRA, and are covered (or considered covered) by an employer retirement plan, complete the worksheets in Appendix B of Publication 590. Use those worksheets to figure your IRA deduction and the taxable portion, if any, of your social security benefits.

Deduction Limits

As just discussed, the deduction you can take for contributions made to your IRA depends on whether you or your spouse is covered for any part of the year by an employer retirement plan. But your deduction is also affected by how much income you have and your filing status, as discussed below under *Adjusted Gross Income Limitation.*

Full deduction. If neither you nor your spouse was covered for any part of the year by an employer retirement plan, you can take a deduction for your total contributions to one or more IRAs of up to $2,000, or 100% of your compensation, whichever is less. Your spouse can also take a total deduction of up to $2,000, or 100% of his or her compensation, whichever is less. This amount is reduced by any contributions to a 501(c)(18) plan (generally a plan created before June 25, 1959, funded entirely by employee contributions).

Reduced or no deduction. If either you or your spouse is covered by an employer retirement plan, you may be entitled to only a partial (reduced) deduction or no deduction at all, depending on your income and your filing status. The deduction begins to decrease ***(phase out)*** when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. The limits vary depending on your filing status.

Adjusted Gross Income Limitation

The effect of income on your deduction, as just described, is sometimes called the adjusted gross income limitation (AGI limit). To compute your ***reduced IRA deduction***, you must first determine your modified adjusted gross income and your filing status.

Modified adjusted gross income (modified AGI) is:

If you file ***Form 1040A***—the amount on the page 1 "adjusted gross income" line, but modified (changed) by figuring it without any IRA deduction, or

If you file ***Form 1040***—the amount on the page 1 "adjusted gross income" line, but modified by figuring it without taking any:

1) IRA deduction,
2) Foreign earned income exclusion,
3) Foreign housing exclusion or deduction, or
4) Exclusion of Series EE bond interest shown on Form 8815, *Exclusion of Interest From Series EE U.S. Savings Bonds Issued After 1989.*

Note. You will find that your modified AGI may include income in addition to your taxable compensation, discussed earlier.

Filing status. Your filing status depends primarily on your marital status. For this purpose, you need to know if your filing status is single (or head of household), married filing jointly, or married filing separately. If you need more information on filing status, see Chapter 2.

Married filing separately exception. If you did not live with your spouse at any time during the year and you file a separate return, your filing status is considered, for this purpose, as single.

Deduction phaseout. Your IRA deduction is reduced or eliminated entirely depending on your filing status and modified AGI as follows:

If your ***filing status*** is:	Your deduction is reduced if your ***modified AGI*** is within the ***phaseout range*** of:	Your deduction is eliminated if your ***modified AGI*** is:
Single, or Head of household	$25,000 to $35,000	$35,000 or more
Married—joint return, or Qualifying widow(er)	$40,000 to $50,000	$50,000 or more
Married—separate return	$ -0- to $10,000	$10,000 or more

Also, see the chart, *Can You Take An IRA Deduction?*, earlier.

How To Figure Your Reduced IRA Deduction

If you are considered covered by an employer retirement plan and your modified AGI is within the phaseout range for your filing status (see the table under *Deduction phaseout*, earlier), your IRA deduction must be reduced. You can figure your reduced IRA deduction (and your allowable nondeductible contributions, which are discussed later) for either Form 1040 or Form 1040A by using the following worksheet. Also, the instructions for these tax forms include an *IRA Worksheet 2*, which you can use instead.

Note. If you were married and both you and your spouse worked and you both contributed to IRAs, figure the deduction for each of you separately.

If you are divorced or legally separated before the end of the year, you cannot deduct any contributions you make to your spouse's IRA. After a divorce or legal separation, you can deduct only the contributions you make to your own IRA, and your deductions are subject to the adjusted gross income limitation rules for single individuals.

Deductible IRA contributions for an unmarried individual or a working spouse. Complete lines 1 through 8 if contributions were made, or will be made, to your IRA.

Worksheet for Reduced IRA Deduction

(Use only if your modified AGI is within the applicable phaseout range—see *Deduction phaseout*, earlier)

If your filing status is:	And your modified AGI is over:	Enter on line 1 below:
Single, or Head of household	$25,000	$35,000
Married—joint return, or Qualifying widow(er)	$40,000	$50,000
Married—separate return	$ -0-	$10,000

1. Enter applicable amount from above ..... _____
2. Enter your ***modified AGI*** (combined, if married filing jointly) ..... _____

Note: If line 2 is equal to or more than the amount on line 1, **stop here;** your IRA contributions are not deductible. See *Nondeductible Contributions*, earlier.

3. Subtract line 2 from line 1. **(If line 3 is $10,000 or more, stop here;** you can take a full IRA deduction for contributions of up to $2,000 or 100% of your compensation, whichever is less.) ..... _____
4. Multiply line 3 by 20% (.20). If the result is not a multiple of $10, round it to the next highest multiple of $10. (For example, $611.40 is rounded to $620.) However, if the result is less than $200, enter $200 ..... _____
5. Enter your compensation. **Do not** include your spouse's compensation, and, if you file Form 1040, do not reduce your compensation by any losses from self-employment. ..... _____
6. Enter contributions you made, or plan to make, to your IRA for 1990, but **do not** enter more than $2,000. (If contributions are more than $2,000, see *Excess Contributions*, later.) ..... _____
7. **IRA deduction.** Compare lines 4, 5, and 6. Enter the smallest amount here. Enter this amount on the Form 1040 or 1040A line for your IRA, whichever applies. (If line 6 is more than line 7 and you want to make a nondeductible contribution, go to line 8.) ..... _____
8. **Nondeductible contributions.** Subtract line 7 from line 5 or 6, whichever is smaller. Enter the result here and on line 2 of your Form 8606. (See *Nondeductible Contributions*, later.) ..... _____

Deductible spousal IRA contributions. Complete lines 9 through 17 below **only if** contributions were made to an IRA for your spouse (see *IRA for your spouse* and *Spousal IRA*, earlier).

9. Enter the smaller of $2,250 or the amount on line 5 ..... _____
10. Add lines 7 and 8. Enter the total. **If this amount is equal to or more than line 9, stop here;** you cannot make contributions to a spousal IRA. Also, see *Excess Contributions*, later. ..... _____
11. Subtract line 10 from line 9 ..... _____
12. Enter the smallest of (a) contributions for 1990 to your spouse's IRA; (b) $2,000; or (c) the amount on line 11. (If contributions are more than $2,000, see *Excess Contributions*, later.) ..... _____
13. Multiply line 3 by 22.5% (.225). If the result is not a multiple of $10, round it to the next highest multiple of $10. However, if the result is less than $200, enter $200 ..... _____
14. Enter the amount from line 7 ..... _____
15. Subtract line 14 from line 13. Enter the result but do not enter more than the amount on line 12 ..... _____
16. **Spousal IRA deduction.** Compare lines 4, 5, and 15. Enter the smallest amount here and on your Form 1040A or 1040. If line 12 is more than line 16 and you want to make a nondeductible contribution for your spouse, go to line 17 ..... _____
17. **Spousal IRA nondeductible contributions.** Subtract line 16 from line 12. Enter the result here and on your spouse's Form 8606, line 2 ..... _____

Reporting Deductible Contributions

If you file ***Form 1040,*** deduct your IRA contributions for 1990 on line 24a and, if you file a joint return, deduct your spouse's IRA contributions on line 24b.

If you file ***Form 1040A,*** deduct your contributions on line 15a and, if you file a joint return, deduct contributions to your spouse's IRA on line 15b.

You can use either form in most cases. ***Form 1040EZ*** does not provide for IRA deductions.

Form 5498. You should receive by May 31, 1991, Form 5498, *Individual Retirement Arrangement Information*, or similar statement, from plan sponsors, showing all the contributions made to your IRA for 1990.

Trustee's fees. Trustee's administrative fees, which are billed separately and paid by you in connection with your IRA, are deductible. They ***are deductible*** (to the extent they are ordinary and necessary) as a miscellaneous deduction on Schedule A (Form 1040). The deduction is subject to the 2% adjusted gross income floor (see chapter 30). ***These fees are not subject to the IRA contribution limit.***

Broker's commissions that you paid in connection with your IRA are subject to the IRA contribution limit. They ***are not deductible*** as a miscellaneous deduction on Schedule A (Form 1040).

Nondeductible Contributions

Although your deduction for IRA contributions may be reduced or eliminated because of the adjusted gross income limitation (see *Deductible Contributions*, earlier) you can still make contributions of up to $2,000 ($2,250 for a regular IRA and a spousal IRA) or 100% of compensation, whichever is less. Generally, the difference between your total permitted contributions and your total deductible contributions, if any, is your ***nondeductible contribution.***

As long as your contributions are within the contribution limits just discussed, none of the earnings on those contributions (deductible or nondeductible) will be taxed until they are distributed. See *When Can I Withdraw or Use Assets From an IRA?*, later.

You will also have a ***cost basis*** in your IRA to the extent of your nondeductible contributions. Your basis is the sum of the nondeductible amounts you have contributed to your IRA less any distributions of those amounts. When you withdraw these amounts representing your basis, as discussed later under *When Can I Withdraw or Use Assets From an IRA?*, you can do so tax free.

Example. Sonny Jones is single. In 1990, he is covered by a retirement plan at work. His salary is $52,312. Sonny makes a $2,000 IRA contribution for 1990. Because he is covered by a retirement plan and his income is over $35,000, he cannot deduct his $2,000 IRA contribution on his 1990 tax return. However, he may choose to either:

1) Designate this contribution as a ***nondeductible*** contribution by reporting it on his tax return, as explained next, or
2) Withdraw the contribution as explained later under *Tax-Free Withdrawal of Contributions.*

Reporting Nondeductible Contributions

You must report nondeductible contributions to the IRS, but you do not have to designate a contribution as nondeductible until you file your tax return. When you file, you can also designate otherwise deductible contributions as nondeductible.

To designate contributions as nondeductible you must file Form 8606, *Nondeductible IRA Contributions, IRA Basis, and Nontaxable IRA Distributions.* You must file Form 8606 to report nondeductible contributions even if you do not have to file a tax return for the year.

File Form 8606 if:

- You made nondeductible contributions to your IRA for 1990, or
- You received IRA distributions in 1990 and you have at any time made nondeductible contributions to any of your IRAs.

If you do not report nondeductible contributions, all of your IRA contributions will be treated as deductible. Thus, when you make withdrawals from your IRA, the amounts you withdraw will be taxed unless you can show, with satisfactory evidence, that nondeductible contributions were made.

Penalty for overstatement. If you overstate the amount of nondeductible contributions on your Form 8606 for any tax year, you must pay a penalty of $100 for each overstatement, unless it was due to reasonable cause.

Penalty for failure to file Form 8606. You will have to pay a $50 penalty if you do not file a required Form 8606, unless you can prove that the failure was due to reasonable cause.

Tax-Free Withdrawal of Contributions.

If you made IRA contributions for 1990, you can withdraw them tax free (except for any earnings on them) by April 15, 1991, (or a later date, if you have an extension to file your return). You can do this if:

- You did not take a deduction for the contributions you withdraw, and
- You also withdraw any interest or other income earned on the contributions. You must report this income on your 1990 return.

Examples – Deductible and Nondeductible Contributions

The following examples illustrate the use of the IRA deduction worksheet shown earlier under *How to Figure Your Reduced IRA Deduction.*

Example 1. For 1990, Tom and Betty Smith file a joint return on Form 1040. They both work and Tom is covered by a retirement plan at work. Tom's salary is $40,000 and Betty's is $6,555. They each have an IRA and their combined modified AGI is $46,555. Since they are covered by an employer plan, and their modified AGI is between $40,000 and $50,000, they can only take a reduced IRA deduction on a joint return (see *Deduction Limits,* earlier).

For 1990, Tom contributed $2,000 to his IRA and Betty contributed $500 to hers. They must use separate worksheets to figure the reduced IRA deduction for each of them because both had IRAs.

Tom can take a deduction of only $690 (see the worksheet below). Even though he contributed the maximum amount allowable ($2,000), $1,310 ($2,000 minus $690) of his contributions must be treated as nondeductible.

He can choose to treat the $690 as either deductible or nondeductible contributions. He can also either leave the $1,310 of nondeductible contributions in his IRA or withdraw them by April 15, 1991. He decides to treat the $690 as deductible contributions and leave the $1,310 of nondeductible contributions in his IRA.

Betty can treat all or part of her contributions as either deductible or nondeductible. This is because her $500 contribution for 1990 is less than the $690 deduction limit for her IRA contributions that year (see line 4 of her worksheet, later). She decides to treat her $500 IRA contributions as deductible.

Using the *Worksheet for Reduced IRA Deduction,* Tom figures his deductible and nondeductible amounts as follows:

Worksheet for Reduced IRA Deduction

(Use only if your modified AGI is within the applicable phaseout range—see *Deduction phaseout,* earlier)

If your *filing status* is:	And your *modified AGI* is over:	Enter on line 1 below:
Single, or Head of household	$25,000	$35,000
Married–joint return, or Qualifying widow(er)	$40,000	$50,000
Married–separate return	$ -0-	$10,000

1. Enter applicable amount from above	50,000
2. Enter your ***modified AGI*** (combined, if married filing jointly)	46,555

Note: If line 2 is equal to or more than the amount on line 1, **stop here;** your IRA contributions are not deductible; see *Nondeductible Contributions,* earlier.

3. Subtract line 2 from line 1. **(If line 3 is $10,000 or more, stop here;** you can take a full IRA deduction for contributions of up to $2,000 or 100% of your compensation, whichever is less.)	3,445
4. Multiply line 3 by 20% (.20). If the result is not a multiple of $10, round it to the next highest multiple of $10. (For example, $611.40 is rounded to $620.) However, if the result is less than $200, enter $200	690
5. Enter your compensation. **Do not** include your spouse's compensation, and, if you file Form 1040, do not reduce your compensation by any losses from self-employment.	40,000
6. Enter contributions you made, or plan to make, to your IRA for 1990, but **do not** enter more than $2,000. (If contributions are more than $2,000, see *Excess Contributions,* later.)	2,000
7. **IRA deduction.** Compare lines 4, 5, and 6. Enter the smallest amount here. Enter this amount on the Form 1040 or 1040A line for your IRA, whichever applies. (If line 6 is more than line 7 and you want to make a nondeductible contribution, go to line 8.)	690
8. **Nondeductible Contributions.** Subtract line 7 from line 5 or 6, whichever is smaller. Enter the result here and on line 2 of your Form 8606. (See *Nondeductible Contributions,* earlier.)	1,310

Betty figures her IRA deduction as follows:

Worksheet for Reduced IRA Deduction

(Use only if your modified AGI is within the applicable phaseout range—see *Deduction phaseout,* earlier)

If your *filing status* is:	And your *modified AGI* is over:	*Enter* on line 1 below:
Single, or Head of household	$25,000	$35,000
Married–joint return, or Qualifying widow(er)	$40,000	$50,000
Married–separate return	$ -0-	$10,000

1. Enter applicable amount from above	50,000
2. Enter your ***modified AGI*** (combined, if married filing jointly)	46,555

Note: If line 2 is equal to or more than the amount on line 1, **stop here;** your IRA contributions are not deductible; see *Nondeductible Contributions,* earlier.

3. Subtract line 2 from line 1. **(If line 3 is $10,000 or more, stop here;** you can take a full IRA deduction for contributions of up to $2,000 or 100% of your compensation, whichever is less.)	3,445
4. Multiply line 3 by 20% (.20). If the result is not a multiple of $10, round it to the next highest multiple of $10. (For example, $611.40 is rounded to $620.) However, if the result is less than $200, enter $200	690
5. Enter your compensation. **Do not** include your spouse's compensation, and, if you file Form 1040, do not reduce your compensation by any losses from self-employment.	6,555
6. Enter contributions you made, or plan to make, to your IRA for 1990, but **do not** enter more than $2,000. (If contributions are more than $2,000, see *Excess Contributions,* later.)	500
7. **IRA deduction.** Compare lines 4, 5, and 6. Enter the smallest amount here. Enter this amount on the Form 1040 or 1040A line for your IRA, whichever applies. (If line 6 is more than line 7 and you want to make a nondeductible contribution, go to line 8.)	500
8. **Nondeductible Contributions.** Subtract line 7 from line 5 or 6, whichever is smaller. Enter the result here and on line 2 of your Form 8606. (See *Nondeductible Contributions,* earlier.)	0

The IRA deductions of $690 and $500 on the joint return for Tom and Betty total $1,190. Betty's unused IRA deduction limit of $190 ($690 – $500) cannot be transferred to Tom to increase his deduction. Tom's deductible IRA contribution for 1990 is still limited to $690.

Example 2. Tom Smith should complete the following lines 9 through 17 of the *Worksheet for Reduced IRA Deductions* to figure the deductible IRA contributions for him and Betty under the same facts as in Example 1, except that he contributed $250 to a spousal IRA because Betty chose to be treated as having no compensation for the year and did not contribute to an IRA. To complete the following, Tom should use lines 1 through 8 of his worksheet.

9. Enter the smaller of $2,250 or the amount on line 5	2,250
10. Add lines 7 and 8. Enter the total. **If this amount is equal to or more than line 9, stop here;** you cannot make contributions to a spousal IRA. Also, see *Excess Contributions,* later.	2,000
11. Subtract line 10 from line 9	250

12.	Enter the smallest of (a) contributions for 1990 to your spouse's IRA; (b) $2,000; or (c) the amount on line 11. (If contributions are more than $2,000, see *Excess Contributions*, later.)	250
13.	Multiply line 3 by 22.5% (.225). If the result is not a multiple of $10, round it to the next highest multiple of $10. However, if the result is less than $200, enter $200	780
14.	Enter the amount from line 7	690
15.	Subtract line 14 from line 13. Enter the result but do not enter more than the amount on line 12	90
16.	**Spousal IRA deduction.** Compare lines 4, 5, and 15. Enter the smallest amount here and on your Form 1040A or 1040. If line 12 is more than line 16 and you want to make a nondeductible contribution for your spouse, go to line 17	90
17.	**Spousal IRA nondeductible contributions.** Subtract line 16 from line 12. Enter the result here and on your spouse's Form 8606, line 2	160

Although Tom contributed the maximum amount (a total of $2,250) to his and Betty's IRAs, because of the adjusted gross income limitation, their allowable IRA deductions total only $780 ($690 + $90).

Can Retirement Plan Assets Be Transferred?

IRA rules permit you to transfer, tax-free, assets (money or property) from other retirement programs (including IRAs) to an IRA. the rules permit the following kinds of transfers:

- Transfers from one trustee to another,
- Rollovers, and
- Transfers incident to a divorce.

Transfer From One Trustee to Another

A transfer of funds in your IRA from one trustee directly to another, either at your request or at the trustee's request, is ***not a rollover.*** It is, however, a tax-free transfer. As such it is not affected by the one-year waiting period that is required between rollovers, discussed next.

Rollovers

A rollover is ***a tax-free distribution*** to you of cash or other assets from one retirement plan that you contribute (roll over) to another retirement plan. The amount you roll over tax free, however, is generally taxable later when the new plan pays that amount to you or your beneficiary.

There are two kinds of rollover contributions to an IRA. In one, you put amounts you receive from one IRA into another. In the other, you put amounts from a qualified (meets IRS requirements) employer retirement plan, such as a qualified pension plan, into an IRA.

You cannot deduct a rollover contribution on your tax return.

You must make the rollover contribution by the 60th day after the day you receive the distribution from your IRA or your employer's plan. If the amount distributed to you from an IRA or a qualified employer retirement plan becomes a frozen deposit in a financial institution during the 60-day period allowed for a rollover, a special rule extends the period. For more information, get Publication 590.

Waiting period between rollovers. You can take (receive) a distribution from a particular IRA and make a rollover contribution to another IRA only once in any one-year period. The one-year period begins on the date you receive the IRA distribution, not on the date you roll it over into another IRA. This rule applies separately to each IRA you own. For details, get Publication 590.

Partial rollovers. If you withdraw assets from an IRA, you may roll over part of the withdrawal tax free into another IRA and keep the rest of it. The amount you keep is generally taxable (except to the extent it is a return of nondeductible contributions) and may be subject to the 10% additional tax on premature distributions discussed later.

If you roll over a distribution from your pension plan into an IRA, the most that you can roll over is the fair market value of the assets that you receive as your share from the plan, minus any nondeductible contributions you made to the plan. Any later distribution to you from that IRA will not qualify for the special averaging and capital gain treatment applicable to lump-sum pension distributions.

If you inherited an IRA from your spouse, you can roll it over as though you had established it.

If you inherited an IRA from someone (other than your spouse) who died after December 31, 1983, you cannot roll it over or allow it to receive a rollover contribution.

Reporting Your Rollover

Report any rollover from a qualified plan into an IRA or other qualified plan on line 17a, Form 1040, or line 11a, Form 1040A. If the total distribution was rolled over, enter zero on line 17b, Form 1040, or line 11b, Form 1040A. Otherwise, enter the taxable part of the distribution on line 17b, Form 1040, or line 11b, Form 1040A. Use lines 16a and 16b, Form 1040, or lines 10a and 10b, Form 1040A, to report rollovers from one IRA to another IRA.

For further information on rollovers, get Publication 590.

Transfers Incident to Divorce

If an IRA is transferred from your spouse or former spouse to you by a decree of divorce or separate maintenance, or a written document related to such a decree, the IRA, starting from the date of the transfer, is treated as your IRA. The transfer is tax free.

When Can I Withdraw or Use Assets From an IRA?

Because an IRA is a tax-favored means of saving for your retirement, there are rules limiting the withdrawal and use of your IRA assets. When you do receive ***distributions*** from an IRA, you must ***generally include in gross income*** for the year any amount that is paid out or distributed to you from the IRA during the tax year. A properly handled rollover, as discussed earlier, is an ***exception*** to this rule, as is a return of nondeductible contributions. For the special rules for figuring the taxable and nontaxable parts of an IRA distribution that includes a return of nondeductible contributions, get Publication 590.

Violation of the rules generally results in additional taxes in the year of violation. See *Prohibited Transactions, Premature Distributions (Early Withdrawals), Excess Accumulations (Insufficient Distributions)* and *Excess Distributions*, later.

Age 59½ rule. Generally, until you reach the age of 59½, you cannot withdraw assets (money or other property) from your IRA without having to pay an additional tax. However, there are a number of exceptions to that rule. See *Premature Distributions (Early Withdrawals)*, later.

Required Distributions

You cannot keep funds in your IRA indefinitely. You must eventually withdraw them or pay an excise tax on excess accumulations in your IRA. See *Excess Accumulations*, later.

Age 70½ rule. After you reach age 70½, you must begin receiving distributions from your IRA. You must choose to withdraw the balance in your IRA in one of the following two ways:

1) By withdrawing the entire balance in your IRA by the required beginning date (defined below), or
2) By starting to withdraw ***periodic distributions*** of the balance in your IRA by the required beginning date.

Required beginning date. You must begin receiving distributions from your IRA by April 1 of the year following the year in which you reach age 70½. If the distributions are to be made over a period of years, the distributions made by April 1 are treated as made for the previous year in which the IRA owner reached age 70½. Required distributions for later years must be made by December 31 of each year.

For more information, including how to figure your required minimum distribution each year, get Publication 590.

Distributions reported on Form 1099–R. You will receive Form 1099–R, *Total Distributions From Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Insurance Contracts, Etc.*, or similar statement, if you receive a total distribution from your IRA. IRA distributions are shown in Boxes 1 and 2 of Form 1099–R. A number in box 7 tells you what type of distribution you received from your IRA.

Distributions reported on Form W–2P. You will receive Form W–2P, *Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments*, if you receive an IRA payment that is not a total distribution. Attach Form W–2P to your tax return.

Reporting taxable distributions on your return. Report fully taxable distributions, including taxable premature distributions, on line 16b, Form 1040 (no entry is required on line 16a), or line 10b, Form 1040A. If only part of the distribution is taxable, enter the total amount on line 16a, Form 1040 (or line 10a, Form 1040A), and the taxable part on line 16b (or line 10b, Form 1040A). You cannot report distributions on Form 1040EZ.

Withholding. Federal income tax is withheld from IRA distributions unless you choose not to have tax withheld.

Distributions paid outside the United States or its possessions. In general, if you are a U.S. citizen or resident alien and your home address is outside the United States or its possessions, you cannot choose exemption from withholding on your IRA payments.

What Acts Result in Penalties?

The tax advantages of using IRAs for retirement savings can be offset by additional taxes and penalties if you do not follow the rules. For example, there are additions to the regular tax for using your IRA funds in prohibited transactions. There are also additional taxes for:

- Making excess contributions,
- Making early withdrawals (taking premature distributions),
- Allowing excess amounts to accumulate (failing to make required withdrawals), or
- Receiving excess distributions.

There are penalties for overstating the amount of nondeductible contributions and for failure to file a required Form 8606. See *Reporting Nondeductible Contributions*, earlier.

Prohibited Transactions

Generally, a prohibited transaction is any improper use of your IRA by you or any ***disqualified person.***

Some examples of disqualified persons for this purpose are:

Your fiduciary, or

Members of your family (spouse, ancestor, lineal descendent, and any spouse of a lineal descendent).

Some examples of prohibited transactions with an IRA are:

- Borrowing money from it,
- Selling property to it,
- Receiving unreasonable compensation for managing it, or
- Using the IRA as collateral for a loan.

Effect on an IRA account. Generally, if you or your beneficiary engage in a prohibited transaction at any time during the year with your IRA, it will not be treated as an IRA as of the first day of the year.

Effect on you (or your beneficiary). If you or your beneficiary engage in a prohibited transaction with your IRA at any time during the year, ***you or your beneficiary must*** include the fair market value of all (or part, in certain cases) of the IRA assets in your gross income for that year. The fair market value is the price at which the IRA assets would change hands between a willing buyer and a willing seller, when neither has any need to buy or sell, and both have reasonable knowledge of the relevant facts.

You must use the fair market value of the assets as of the first day of the year you engaged in the prohibited transaction. You may also have to pay the 10% additional tax on premature distributions, discussed later.

Excise Taxes. Those involved in prohibited transactions may be liable for certain excise taxes. In general, there is a 5% tax on the amount of the prohibited transaction and a 100% additional tax if the transaction is not corrected.

Investment in collectibles. If your IRA invests in collectibles, the amount invested is considered distributed to you in the year invested. You may have to pay the 10% additional tax on premature distributions.

Collectibles include art works, rugs, antiques, metals, gems, stamps, coins, alcoholic beverages, and other tangible personal property if specified by the IRS.

Exception. Your IRA can invest in one, one-half, one-quarter, or one-tenth ounce U.S. gold coins, or one ounce silver coins minted by the Treasury Department beginning October 1, 1986.

For more information on prohibited transactions, get Publication 590.

Excess Contributions

Generally, an excess contribution is the amount contributed to your IRA(s) for the year that is more than the smaller of the following amounts:

- Your taxable compensation for the year, or
- $2,000.

Example. You were single and earned $30,000 in 1990. You contributed $2,500 to your IRA for 1990. Your contribution limit is $2,000. Your reduced IRA deduction, figured using the *Worksheet for Reduced IRA Deduction*, is $1,000. You made an excess contribution for 1990 of $500 ($2,500 minus $2,000).

Tax on excess contributions. You must pay a 6% excise tax each year on excess amounts that remain in your IRA at the end of your tax year. The excess is taxed for the year the excess contribution is made and for each year after that until you correct it. The tax cannot be more than 6% of the value of your IRA as of the end of your tax year. The tax does not apply to a rollover contribution.

Excess contributions you withdraw by the date your return is due. You will not have to pay the 6% excise tax if you withdraw the excess amount ***and*** interest or other income earned on it by the due date of your return, including extensions.

You do not have to include in your gross income an excess contribution that you withdraw from your IRA before your tax return is due if you did not take a deduction for that excess amount on your return, and the interest or other income earned on the excess was also withdrawn.

However, ***you must include*** in your gross income any interest or other income earned on the excess contributions (whether deductible or nondeductible contributions). Report it on your return for the year the excess contribution was made.

Excess contributions you withdraw after your return is due. If the total contributions (other than rollover contributions) for the year were $2,250 or less, and there are no employer contributions, you may withdraw any excess contribution after the due date for filing your return, including extensions. You do not include the withdrawn contributions in your income. This applies only to the part of the excess for which you did not take a deduction.

Premature Distributions (Early Withdrawals)

You must include premature distributions in your gross income and, because they are premature, there will be an ***additional 10% tax*** on them. Use Form 5329 (discussed later) to figure the tax.

Premature distributions are amounts you withdraw from your IRA before you are 59½.

Exceptions. The 10% tax will not apply to the following distributions:

- Portions of any distributions treated as a return of nondeductible contributions,
- Distributions made after the owner's death,
- Distributions made because you become disabled,
- Distributions that are a part of a series of substantially equal payments over your life (or life expectancy), or over the lives of you and your beneficiary (or your life expectancies), For this exception to apply, you must take at least one distribution annually. Also, the payments must continue for at least 5 years, or until you reach age 59½, whichever is the longer period. This 5-year rule does not apply if the payment change is because of the death or disability of the IRA owner, and
- Distributions that are rolled over, as discussed earlier under *Rollovers.*

For more information on premature distributions, get Publication 590.

Excess Accumulations (Insufficient Distributions)

If distributions from your IRA(s) during the year are less than the required minimum distribution for the year, you may have to pay a ***50% excise tax*** for that year on the excess amount remaining in your IRA.

If the excess accumulation is due to reasonable error and you have taken steps to remedy the insufficient distribution, you can request that the tax be excused.

For more information on excess accumulations, get Publication 590.

Excess Distributions

If you received *retirement distributions* during the year of more than $150,000, you may have to pay a ***15% excise tax*** on the distributions exceeding that amount. The term ***"retirement distributions"*** means your distributions from any qualified employer or tax-sheltered annuity plans, or IRAs.

This excise tax is reduced by any tax on premature distributions that applies to the excess distribution. See *Premature Distributions*, discussed earlier.

Excluded distributions. The excess distribution tax does not apply to the following distributions:

- Distributions after the employee's death,
- Distributions that are rolled over, and
- Distributions that represent nondeductible contributions.

For more information on excess distributions, get Publication 590.

Reporting Additional Taxes

Use **Form 5329,** *Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts,* to report the tax on excess contributions, premature distributions, excess distributions, and excess accumulations.

You also must file Form 5329 if you:

- Meet an exception to the 10% additional tax on early (premature) distributions, but only if the exception is ***not*** shown on the ***Form 1099*** or ***Form W-2P*** that you received for the distribution, or
- Receive excess distributions from a qualified retirement plan, whether or not you owe tax on them.

If you file Form 1040, complete Form 5329 and attach it to your Form 1040. Enter the total amount of IRA tax due on line 52, Form 1040.

If you do not have to file a Form 1040 but do have to pay one of the IRA taxes mentioned earlier, file the completed Form 5329 with IRS at the time and place you would have filed your Form 1040. Include a check or money order payable to IRS for the tax you owe, as shown on Form 5329. Write your social security number, tax form number, and tax year on your check or money order.

Simplified Employee Pension (SEP)

A simplified employee pension (SEP) is a written plan that allows an employer to make contributions toward his or her own (if a self-employed individual) and his or her employees' retirement, without becoming involved in more complex retirement plans.

The SEP rules permit an employer to contribute (and deduct) each year to each participating employee's SEP-IRA up to 15% of the employee's compensation or $30,000, whichever is less ***(the contribution limit)***. The contributions are funded by the employer.

Deduction limit for a self-employed person. If you are self-employed and contribute to your own SEP-IRA, special rules apply when figuring your maximum deduction for these contributions.

In determining the percentage limit on contributions, discussed above, your ***compensation*** is your net earnings from self-employment. See *Net earnings*, below. You will note that, for this purpose, your net earnings must take into account your deduction for contributions to your own SEP-IRA. Because the deduction amount and the net earnings amount are each dependent on the other, this adjustment presents a problem.

To solve this problem, you make the adjustment to net earnings indirectly by reducing the contribution rate called for in the plan. Use the following worksheet to find this reduced contribution rate and your maximum deduction. Make no reduction to the contribution rate for any common-law employees.

1) Contribution rate in plan shown as a decimal	_____
2) Rate in line (1) plus one	_____
3) Reduced rate for self-employed person (divide line (1) by line (2)	_____
4) Net earnings (if more than $209,200, see Publication 560) not reduced for contributions to your SEP-IRA	_____
5) Maximum deduction for contributions to self-employed person's SEP-IRA (multiply line (4) by line (3))	_____

Example. You are a sole proprietor and have employees. The terms of your SEP provide that you contribute for yourself 15% of your net earnings, and for your employees 15% of their pay. Your net earnings from your business (not taking into account a deduction for contributions to your own SEP-IRA) are $196,000. In figuring this amount, you deducted your employees' pay of $60,000 and contributions for them of $9,000 (15% of $60,000). Using the worksheet, you figure your maximum deduction for contributions to your own SEP-IRA as follows.

1) Contribution rate in plan shown as a decimal	.15
2) Rate in line (1) plus one	1.15
3) Reduced rate for self-employed person (divide line (1) by line (2)	.130435
4) Net earnings (if more than $209,200, see Publication 560) not reduced for contributions to your SEP-IRA	$196,000
5) Maximum deduction for contributions to self-employed person's SEP-IRA (multiply line (4) by line (3))	$25,565

Net earnings. For SEP purposes, your net earnings are your gross income from your business minus your allowable deductions for that business. Allowable deductions include contributions to your own SEP-IRA and to those of your employees. You must also reduce your earnings by the deduction for one-half of your self-employment tax. Net earnings do not include tax-free items or deductions related to them.

The contribution limit (lesser of 15% of compensation or $30,000) discussed above also applies to any amounts you elect to have taken out of your income and contributed to the plan under a *salary reduction arrangement*, discussed later.

The contribution limit discussed above does not apply to contributions up to your IRA contribution limit that you make during the year to your SEP-IRAs or regular IRAs independent of your employer's contributions. See *How Much Can I Contribute and Deduct?*, earlier.

Salary reduction arrangement. A SEP may include a salary reduction arrangement. Under the arrangement, you can elect to have your employer contribute part of your pay to the SEP-IRA. Only the remaining portion of your pay is currently taxable. The tax on the contribution is deferred. This election is called an elective deferral.

Employer's SEP contributions excluded from your wages on Form W-2. Your employer's contributions to your SEP-IRA are generally excluded from your income (rather than deducted from it). Therefore, your employer's contributions should not be included in your Form W-2 wages. However, if you choose to have your employer make SEP contributions out of your salary under a salary reduction agreement, these contributions are included in Form W-2 wages for social security (FICA) tax purposes only.

Even if your employer makes contributions to your SEP-IRA, ***you can*** deduct the contributions you make to your SEP-IRA or another IRA. The IRA deduction rules (covered earlier) apply to any amounts you contribute to your IRAs.

Tax treatment by self-employed individuals. If you are self-employed (a sole proprietor or partner) with a SEP, take your deduction for contributions to your own SEP-IRA on line 27, Form 1040.

Excess contributions. If your employer contributes too much to your SEP-IRA, resulting in an excess contribution, you will not have to pay the 6% excise tax on it if you withdraw this excess amount (and interest or other income earned on it) from your SEP-IRA before the due date for filing your tax return, including extensions. However, you must include the excess contribution in your gross income. Your Form W-2 should include the amount.

For more information on a SEP-IRA, get Publication 590.

20. Alimony

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It includes ***separate maintenance payments.***

Alimony is deductible by the payer and must be included in the spouse's or former spouse's income. Although this discussion is generally written for the payer of the alimony, the recipient can use the information to determine whether an amount received is alimony.

To be alimony, a payment must meet certain requirements. Different requirements apply to payments under instruments executed after 1984 and to payments under instruments executed before 1985. This chapter discusses some general rules and the specific rules for payments under instruments executed after 1984. For the rules for payments under pre-1985 instruments, see Publication 504, *Tax Information for Divorced or Separated Individuals.*

Spouse or former spouse. Unless otherwise stated in the following discussions about alimony, the term "spouse" includes "former spouse."

Divorce or separation instrument. The term "divorce or separation instrument" means:

- A decree of divorce or separate maintenance or a written instrument incident to that decree,
- A written separation agreement, or
- A decree or any type of court order requiring a spouse to make payments for the support or maintenance of the other spouse, including a temporary decree, an interlocutory (not final) decree, and a decree of alimony *pendente lite* (while awaiting action on the final decree or agreement).

Deducting alimony paid. You can deduct alimony you paid, whether or not you itemize deductions on your return. Enter the alimony on line 29 of Form 1040. You cannot use Form 1040A or Form 1040EZ.

In the space on line 29, enter your spouse's or former spouse's social security number. If you do not, you may have to pay a $50 penalty and your deduction may be disallowed.

If you paid alimony to more than one person, enter the social security number of one of the recipients. Show the social security number and amount paid for each recipient on an

attached statement. Enter your total payments on line 29.

Reporting alimony received. Report alimony you received on line 11 of Form 1040. You cannot use Form 1040A or Form 1040EZ.

You must give the person who paid the alimony your social security number. If you do not, you may have to pay a $50 penalty.

General Rules

The following rules apply to alimony regardless of when the divorce or separation instrument was executed.

Payments not alimony. Not all payments under a divorce or separation instrument are alimony. Alimony does not include:

- Child support,
- Noncash property settlements,
- Payments that are your spouse's part of community income (see *Community Property*, in Publication 504),
- Use of property, or
- Payments to keep up the payer's property.

Alimony also does not include payments not required by a divorce or separation instrument.

Payments to a third party. Payments to a third party on behalf of your spouse under the terms of your divorce or separation instrument may be alimony, if they otherwise qualify. This includes payments for your spouse's medical expenses, housing costs (rent, utilities, etc.), taxes, tuition, etc. The payments are treated as received by your spouse and then paid to the third party. See Publication 504 for examples.

Life insurance premiums. Premiums you must pay under your divorce or separation instrument for insurance on your life qualify as alimony to the extent your spouse owns the policy.

Payments for jointly-owned home. If your divorce or separation instrument states that you must pay expenses for a home owned by you and your spouse, some of your payments may be alimony. See Publication 504 for information.

Instruments Executed After 1984

The following rules for alimony apply to payments under divorce or separation instruments executed after 1984. They also apply to payments under pre-1985 instruments that have been changed to specify that these rules will apply.

A divorce or separation instrument executed after 1984 is treated as executed before 1985 if it includes without change the terms for alimony under a pre-1985 instrument. A change in the terms for alimony includes a change in the amount or period of payment and the addition or deletion of any contingencies or conditions. For examples, see Publication 504.

Alimony requirements. A payment to or for a spouse under a divorce or separation instrument is alimony if the spouses do not file a joint return and all the following requirements are met:

- The payment is in cash.
- The instrument does not designate the payment as not alimony.
- If the spouses are separated under a decree of divorce or separate maintenance, they are not members of the same household when the payment is made.
- There is no liability to make any payment (in cash or property) after the death of the recipient spouse.
- The payment is not treated as child support.
- For instruments executed in 1985 or 1986, the minimum term rule is met.

These requirements are discussed below.

Payment must be in cash. Only cash payments, including checks and money orders, qualify as alimony. Transfers of services or property (including a debt instrument of a third party or an annuity contract), execution of a debt instrument, or the use of property do not qualify as alimony.

Payments to a third party. Cash payments to a third party under the terms of your divorce or separation instrument can qualify as a cash payment to your spouse. See *Payments to a third party* under *General Rules*, earlier.

Also, cash payments made to a third party at the written request of your spouse qualify as alimony if both the following requirements are met:

- The written request states that both spouses intend the payments to be treated as alimony.
- You receive the written request from your spouse before you file your return for the year you made the payments.

Payments designated as not alimony. You and your spouse may designate that otherwise qualifying payments are not alimony by including a provision in your divorce or separation instrument that the payments are not deductible by you and are excludable from your spouse's income. For this purpose, any writing signed by both of you that makes this designation and that refers to a previous written separation agreement is treated as a written separation agreement. If you are subject to temporary support orders, the designation must be made in the original or a subsequent temporary support order.

To exclude the payments from income, your spouse must attach a copy of the instrument designating them as not alimony to his or her return for each year the designation applies.

Spouses cannot be members of the same household. Payments to your spouse while you are members of the same household are not alimony if you are separated under a decree of divorce or separate maintenance. A home you formerly shared is considered one household, even if you physically separate yourselves in the home.

You are not treated as members of the same household if one of you is preparing to leave the household and does leave not more than one month after the date of the payment.

Exception. If you are not legally separated under a decree of divorce or separate maintenance, a payment under a written separation agreement, support decree or other court order may qualify as alimony or separate maintenance even if you are members of the same household when the payment is made.

Liability for payments after death of recipient spouse. If you must continue to make payments for any period after your spouse's death, none of the payments made before or after the death are alimony.

The divorce or separation instrument does not have to expressly state that the payments cease upon the death of your spouse if, for example, the liability for continued payments would end under state law.

Example. You must pay your former spouse $10,000 in cash each year for 10 years. Your divorce decree states that the payments will end upon your former spouse's death. You must also pay your former spouse or your former spouse's estate $20,000 in cash each year for 10 years.

The $10,000 annual payments are alimony. But because the $20,000 annual payments will not end upon your former spouse's death, they are not alimony.

Substitute payments. If you must make any payments in cash or property after your spouse's death as a substitute for continuing otherwise qualifying payments, the otherwise qualifying payments are not alimony. Payments may be considered substitute payments, depending on the facts and circumstances, to the extent that any payments are to begin, increase in amount, or become accelerated in time as a result of your spouse's death.

Example 1. Under your divorce decree, you must pay your former spouse $30,000 annually. The payments will stop at the end of 6 years or upon your former spouse's death, if earlier.

Your former spouse has custody of your minor children. The decree provides that if any of those children are still minors at your spouse's death, you must pay $10,000 annually to a trust until the youngest child reaches the age of majority. The trust income and corpus (principal) are to be used for your children's benefit.

These facts indicate that the payments to be made after your former spouse's death are a substitute for $10,000 of the $30,000 annual payments. Therefore, $10,000 of each of the $30,000 annual payments is not alimony.

Example 2. Under your divorce decree, you must pay your former spouse $30,000 annually. The payments will stop at the end of 15 years or upon your former spouse's death, if earlier. The decree provides that if your former spouse dies before the end of the 15-year period, you must pay the estate the difference between $450,000 ($30,000 × 15) and the total amount paid up to that time. For example, if your spouse dies at the end of the tenth year, you must pay the estate $150,000 ($450,000 − $300,000).

These facts indicate that the lump-sum payment to be made after your former spouse's death is a substitute for the full amount of the $30,000 annual payments. Therefore, none of the annual payments are alimony. The result would be the same if the payment required at death were to be discounted by an appropriate interest factor to account for the prepayment.

Child support. A payment that is fixed or treated as fixed as child support under your divorce or separation instrument is not alimony. A payment is ***fixed*** as child support if your instrument specifically designates an amount or part of the payment as support for your child. The designated amount or part may vary from time to time. Child support payments are neither deductible by the payor, nor taxable to the payee.

A payment will be ***treated as fixed*** as child support if the payment is reduced either:

On the happening of a contingency relating to your child, or

At a time that can be clearly associated with the contingency.

A payment may be treated as fixed as child support even if other separate payments are specifically designated as child support.

Contingency relating to your child. A contingency relates to your child if it depends on any event relating to that child. It does not matter whether the event is certain or likely to occur. Events relating to your child include:

Reaching a specified age or income level,

Dying,

Marrying,

Leaving school,

Leaving the household, or

Becoming employed.

Clearly associated with a contingency. Payments are presumed to be reduced at a time clearly associated with the happening of a contingency relating to your child only in the following situations:

The payments are to be reduced not more than 6 months before or after the date the child will reach 18, 21, or local age of majority.

The payments are to be reduced on two or more occasions that occur not more than one year before or after a different child reaches a certain age from 18 to 24. This certain age must be the same for each child, but need not be a whole number of years.

In all other situations, reductions in payments are not treated as clearly associated with the happening of a contingency relating to your child.

Either you or the Internal Revenue Service may defeat the presumption in the two situations above. This is done by showing that the time at which the payments are to be reduced was determined independently of any contingencies relating to your children. For example, you can defeat the presumption by showing that alimony payments are to be made for a period customarily provided in the local jurisdiction, such as a period equal to one-half the duration of the marriage.

Minimum term rule. This rule applies only to payments made under a decree of divorce or separate maintenance, or a written separation agreement, executed in 1985 or 1986. Under this rule, the part of an annual payment that is more than $10,000 is not alimony unless payments will be made for at least 6 consecutive calendar years beginning with the first year alimony is paid.

To determine the first year alimony was paid, disregard payments under a support decree or other court order. Consider only payments qualifying as alimony under a decree of divorce or separate maintenance, or a written separation agreement. In determining whether a payment will be made in any future year, ignore the possible termination of payments because of a contingency (other than the passage of time) that has not yet happened, unless the contingency causes part of the payment to be treated as child support.

Example. Under your divorce decree, you must pay your former spouse $20,000 in each of the 5 calendar years 1986 through 1990. You are to make no payment in 1991.

Under the minimum term rule, only $10,000 of each annual payment will be alimony. If the divorce decree also required you to pay $1 in 1991, the full $20,000 annual payments would be alimony.

Exception. If a divorce or separation instrument executed in 1985 or 1986 is modified to specify that the 1986 Tax Reform Act changes are to apply, the minimum term rule will not apply to the tax year in which the modification is made and all later years.

Recapture Rule

The recapture rule changes the tax treatment of past payments by requiring you to include previously deducted alimony in income. It also allows your spouse, who previously included the alimony in income, to deduct the recaptured amount.

The recapture rule may apply if alimony payments are reduced or terminated during the first 3 calendar years. These 3 years start with the first calendar year you make a payment qualifying as alimony under a decree of divorce or separate maintenance, or a written separation agreement. Do not take into account payments under a support decree or other court order. The second and third years are the next 2 calendar years, whether or not payments are made during those years.

The reasons for a reduction or termination of alimony payments can include:

A failure to make timely payments,

A change in your instrument,

A reduction in your spouse's support needs, or

A reduction in your ability to provide support.

Exceptions. The recapture rule does not apply unless your annual alimony payments decrease by more than certain dollar amounts (floors). For instruments executed after 1986, the floor is $15,000. For instruments executed in 1985 or 1986, the floor is $10,000.

You do not have to recapture any of the following payments, regardless of their amount:

Payments under a temporary support order before your divorce or separation,

Payments required over a period of at least 3 calendar years of a fixed part of your income from a business or property, or from compensation for employment or self-employment, or

Payments that end because you or your spouse dies or your spouse remarries within the first 3 calendar years of payments.

Including the recapture in income. If you must include a recapture amount in income, show it on Form 1040, line 11 ("Alimony received"). Cross out "received" and write "recapture." On the dotted line next to the amount, enter your spouse's last name and social security number.

Deducting the recapture. If you can deduct a recapture amount, show it on Form 1040, line 29 ("Alimony paid"). Cross out "paid" and write "recapture." In the space provided, enter your spouse's social security number.

Instruments executed after 1986. This recapture rule applies to payments under divorce or separation instruments executed after 1986. It also applies to payments under pre-1987 instruments that have been changed to specify that the 1986 Tax Reform Act changes will apply.

Alimony paid under these instruments during both the first and second calendar years is subject to recapture in the third calendar year. For example, if you first paid alimony in 1988, your payments during 1988 and 1989 are subject to recapture on your 1990 return.

Both you and your spouse can use the filled-in worksheet on the next page, substituting your own figures, to figure recaptured alimony. Publication 504 has a blank worksheet for your use.

Example. Myrna pays Phil the following amounts of alimony under their 1988 divorce decree:

Year	Amount
1988	$60,000
1989	40,000
1990	20,000

The recaptured alimony is $22,500, as shown in a filled-in *Worksheet for Recapture of Alimony.*

Myrna shows $22,500 as income on line 11 of her 1990 Form 1040. Phil deducts $22,500 on line 29 of his 1990 Form 1040.

Instruments executed in 1985 or 1986. This recapture rule applies to payments under divorce or separation instruments executed in 1985 or 1986 (or pre-1985 instruments changed to include the tax changes made by the Tax Reform Act of 1984) and not changed to specify that the 1986 Tax Reform Act changes are to apply.

Alimony paid under these instruments is subject to recapture in both the second and third calendar years (the computation years). If the alimony you paid in a computation year is more than $10,000 less than the alimony you paid in any earlier calendar year, you must figure the amount to be recaptured for that computation year.

The amount to be recaptured for any computation year is the sum of excess amounts determined for each earlier year. The excess amount is the alimony paid in the earlier year that is more than $10,000 plus the alimony paid during the computation year.

For this calculation, the alimony paid during any year before the computation year is reduced by any excess amount previously determined for that earlier year.

Example. You were divorced in 1986. Your divorce decree has not been changed to specify that the 1986 Tax Reform Act changes are to apply. Your first payment that qualifies as alimony was made in 1988. You paid alimony to your former spouse of $25,000 in 1988, $12,000 in 1989, and $1,000 in 1990.

The excess amount for 1988 that is recaptured in 1989 is $3,000 [$25,000 − ($12,000 + $10,000)]. For 1990, the amount considered paid in 1988 is $22,000.

The excess amount that is recaptured in 1990 is $12,000. This is the sum of an $11,000 excess amount for 1988 [$22,000 − ($1,000 + $10,000)] and a $1,000 excess amount for 1989 [$12,000 − ($1,000 + $10,000)].

Note. If the first alimony payment were made in 1987 (instead of 1988), alimony payments made under the divorce decree would not be subject to recapture after 1989 since the recapture rule applies only to the 3-calendar-year period beginning with the first calendar year in which the alimony is paid.

Worksheet for Recapture of Alimony
(For instruments executed after 1986)

Note: Do not enter less than zero on any line.

1. Alimony paid in **2nd year**		$40,000	
2. Alimony paid in **3rd year**	$20,000		
3. Floor	$15,000		
4. Add lines 2 and 3		35,000	
5. Subtract line 4 from line 1			$ 5,000
6. Alimony paid in **1st year**		60,000	
7. Adjusted alimony paid in **2nd year** (line 1 less line 5)	35,000		
8. Alimony paid in **3rd year**	20,000		
9. Add lines 7 and 8	55,000		
10. Divide line 9 by 2	27,500		
11. Floor	$15,000		
12. Add lines 10 and 11		42,500	
13. Subtract line 12 from line 6			17,500
14. **Recaptured alimony.** Add lines 5 and 13			$ 22,500

* **If you deducted alimony paid**, report this amount as income on line 11, Form 1040.

If you reported alimony received, deduct this amount on line 29, Form 1040.

Part V
Standard Deduction and Itemized Deductions

After you have figured your adjusted gross income, you are ready to subtract the deductions used to figure taxable income. You can subtract either the standard deduction or itemized deductions. For the most part, itemized deductions are deductions for various kinds of personal expenses that are listed on Schedule A (Form 1040). See the chart below for the factors to consider for each type of deduction. The chapters in this part discuss the standard deduction and each itemized deduction.

SHOULD YOU TAKE THE STANDARD DEDUCTION OR SHOULD YOU ITEMIZE YOUR DEDUCTIONS?

Take the standard deduction IF:

- Your standard deduction (Chapter 21) is more than the total itemized deductions you can claim,
- You are not filing a tax return with a short tax year,
- You were not a dual status alien during the year (see Chapter 21), and
- If you are married filing separately, your spouse does not itemize deductions.

Itemize your deductions IF:

- You cannot take the standard deduction (Chapter 21),

or

- You had large uninsured medical and dental expenses (Chapter 22),
- You paid taxes and interest on your home (Chapters 23 and 24),
- You made large charitable contributions (Chapter 25),
- You had large uninsured casualty or theft losses (Chapter 26),
- You had certain moving expenses (Chapter 27),
- You had employee business expenses (Chapter 28),
- You had employee educational expenses (Chapter 29), or
- You had various miscellaneous expenses (Chapter 30),

and

- Your total itemized deductions are more than the standard deduction you can claim (Chapter 21).

21. Standard Deduction

Important Change for 1990

Standard deduction. The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040, is higher in 1990 than it was in 1989. The amount depends upon your filing status.

Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. The standard deduction is a dollar amount which reduces the amount of income on which you are taxed. It is a benefit which reduces the need for many taxpayers to itemize actual deductions, such as medical expenses, charitable contributions, or taxes, on Schedule A of Form 1040. The benefit is higher for taxpayers who are 65 or older or blind. If you have a choice, you should use the method which gives you the lower tax.

Persons not eligible for the standard deduction. Your standard deduction is *zero* and you should itemize any deductions you have if:

1) You are married and filing a separate return, and your spouse itemizes deductions,
2) You are filing a tax return with a short tax year, or
3) You are a nonresident or dual-status alien during the year. You are considered a dual-status alien if you were both a nonresident alien and a resident alien during the year.

Note. If you file a joint return with your spouse who was a U.S. citizen or resident at the end of 1990 and you both agree to be taxed as U.S. citizens or resident aliens for the entire year, you may take the standard deduction that applies to you.

Dependents may have a limited standard deduction. If you can be claimed as a dependent on another person's return (such as your parents' return), your standard deduction may be limited. See *Standard Deduction for Dependents*, later.

You benefit from the standard deduction if your standard deduction is more than the total of your allowable itemized deductions.

The standard deduction amounts for most taxpayers are shown on the *Standard Deduction Chart for Most People* in this chapter.

The amount of the standard deduction for a decedent's final return is the same as it would have been had the decedent continued to live. However, if the decedent was not 65 or older at the time of death, the higher standard deduction for age cannot be claimed.

Higher standard deduction for age (65 or older). If you do not itemize deductions, you are entitled to a higher standard deduction if you are age 65 or older at the end of the year. You are considered 65 on the day before your 65th birthday. Therefore, you may take a higher standard deduction for 1990 if your 65th birthday was on or before January 1, 1991.

See the *Standard Deduction Chart for People Age 65 or Older or Blind* in this chapter to figure the standard deduction amount you are entitled to.

Higher standard deduction for blindness. If you are blind on the last day of the year and you do not itemize deductions, you are entitled to a higher standard deduction as shown in the *Standard Deduction Chart for People Age 65 or Older or Blind*. You qualify for this benefit if you are totally or partly blind.

Totally blind. Attach a statement to this effect to your return.

Partly blind. You must submit with your return each year a certified statement from an eye physician or registered optometrist that:

1) You cannot see better than 20/200 in the better eye with glasses or contact lenses, or
2) Your field of vision is not more than 20 degrees.

If your eye condition will never improve beyond these limits, you can avoid having to get a new certified statement each year by having the examining eye physician include this fact in the certification you attach to your return. In later years just attach a statement referring to the certification. You should keep a copy of the certification in your records.

If your vision can be corrected beyond these limits only by contact lenses that you can wear only briefly because of pain, infection, or ulcers, you may take the higher standard deduction for blindness if you otherwise qualify.

Spouse 65 or older or blind. You may take the higher standard deduction if your spouse is age 65 or older or blind and:

1) You file a joint return, or
2) You file a separate return, and your spouse had no gross income and could not be claimed as a dependent by another taxpayer.

Note. You may not claim the higher standard deduction for an individual, other than your spouse, for whom you can claim an exemption.

Example 1. Larry, 45, and Donna, 42, are filing a joint return for 1990. Neither is blind. They decide not to itemize their deductions. Their standard deduction is $5,450.

Example 2. Assume the same facts as in *Example 1*, except that Larry is blind at the end of 1990. Larry and Donna's standard deduction is $6,100.

Example 3. Bill and Terry are filing a joint return for 1990. Both are over age 65. Neither is blind. If they do not itemize deductions, their standard deduction is $6,750.

How to report. After you find your standard deduction amount, enter it on line 19 of Form 1040A or line 34 of Form 1040. If you use Form 1040EZ, your standard deduction is combined with your personal exemption and entered on line 4. If the total of your standard deduction and personal exemption is more than $5,300, you must file Form 1040A or Form 1040.

Standard Deduction for Dependents

The standard deduction for an individual who can be claimed as a dependent on another person's tax return is generally limited to the greater of (a) $500, or (b) the individual's earned income for the year (but not more than the regular standard deduction amount, generally $3,250).

However, if you are a dependent who is 65 or older or blind, your standard deduction may be higher.

If you are a dependent, use the *Standard Deduction Worksheet for Dependents*, in this chapter to determine your standard deduction.

Earned income is salaries, wages, professional fees, and other amounts received as pay for work you actually perform.

Earned income includes any part of a ***scholarship or fellowship grant*** that you must include in your gross income. See *Scholarships and Fellowship Grants* in Chapter 13 for more information on what qualifies as a scholarship or fellowship grant.

After you find your standard deduction amount, enter it on line 19 of Form 1040A or line 34 of Form 1040. If you use Form 1040EZ, your standard deduction is figured on the back of the form and entered on line 4. If your standard deduction is more than $3,250, you should file Form 1040A or Form 1040.

Example 1. Michael, who is single, is claimed as a dependent on his parent's 1990 tax return. He has interest income of $600 and wages of $150. He has no itemized deductions. Michael uses the *Standard Deduction Worksheet for Dependents* to find his standard deduction. It is $500 because the greater of $500 or his earned income ($150) is $500.

Example 2. Joe, a 22-year-old full-time college student, is claimed as a dependent on his parents' 1990 tax return. Joe is married and files a separate return. His wife does not itemize deductions on her separate return.

Joe has $1,500 in interest income and wages of $2,900. He has no itemized deductions. Joe finds his standard deduction by using the *Standard Deduction Worksheet for Dependents*. He enters his earned income, $2,900, on line 1. On line 3 he enters $2,900, the larger of his earned income ($2,900), or $500. Since Joe is married filing a separate return, he enters $2,725 on line 4. On line 5a he enters $2,725 because it is smaller than $2,900, his earned income. This is his standard deduction.

Example 3. Amy, who is single, is claimed as a dependent on her parents' 1990 tax return. She is 18 years old and blind. She has interest income of $900 and wages of $3,000. She has no itemized deductions. Amy uses the *Standard Deduction Worksheet for Dependents* to find her standard deduction. She enters her wages of $3,000 on line 1. On line 3 she enters $3,000, the larger of her wages on line 1 and the $500 on line 2. Since she is single, Amy enters $3,250 on line 4. She enters $3,000 on line 5a. This is the smaller of the amounts on lines 3 and 4. Because she checked one box in the top part of the worksheet, she enters $800 on line 5b. She then adds the amounts on lines 5a and 5b and enters her standard deduction of $3,800 on line 5c.

Who Should Itemize

Some taxpayers should itemize their deductions because it will save them money. Others should itemize because they do not qualify for the standard deduction, as discussed earlier under *Persons not eligible for the standard deduction.*

You should itemize your deductions if the total of your itemized deductions is more than the standard deduction to which you otherwise would be entitled.

You may benefit from itemizing your deductions on Schedule A of Form 1040 if you:

1) Do not qualify for the standard deduction, or the amount you can claim is limited,
2) Had large uninsured medical and dental expenses during the year,
3) Paid interest and taxes on your home,
4) Had large unreimbursed employee business expenses or other miscellaneous deductions,
5) Had large casualty or theft losses not covered by insurance,
6) Made large contributions to qualified charities, or
7) Your total itemized deductions are more than the highest standard deduction to which you otherwise are entitled.

These deductions are explained in Chapters 22-30.

If you decide to itemize your deductions, complete Schedule A and attach it to your Form 1040. Enter the amount from Schedule A, line 27, on Form 1040, line 34 and check the box.

If you itemize even though your itemized deductions are less than the amount of your standard deduction, write "IE" (itemized elected) on the dotted line to the left of line 34 (Form 1040).

Changing your mind. If you do not itemize your deductions and later find that you should have itemized — or if you itemize your deductions and later find you should not have — you may change your return by filing Form 1040X, *Amended U.S. Individual Income Tax Return.* See *Amended Returns and Claims for Refund* in Chapter 1 for more information on amended returns.

If you are married and filed separate returns, you may change methods of taking deductions only if you and your spouse both make the same changes. Both of you must file a consent to assessment for any additional tax either one may owe as a result of the change.

You and your spouse can use the method that gives you the lowest total tax, even though one of you may pay more tax than the other. You ***both must use the same method*** of claiming deductions. If one itemizes deductions, the other should itemize because he or she will not qualify for the standard deduction (see *Persons not eligible for the standard deduction*, earlier).

Caution. If you are married filing a separate return and your spouse itemizes deductions, or if you are a dual-status alien, you cannot take the standard deduction even if you were 65 or older or blind.

Standard Deduction Chart for Most People

DO NOT use this chart if you were 65 or older or blind, OR if someone can claim you as a dependent.

If your Filing Status is:	Your standard deduction is:
Single	$3,250
Married filing joint return or Qualifying widow(er) with dependent child	$5,450
Married filing separate return	$2,725
Head of household	$4,750

Standard Deduction Chart for People Age 65 or Older or Blind

If someone can claim you as a dependent, use the worksheet below, instead.

If you were 65 or older or blind, check the correct number of boxes below. Then go to the chart.

You	65 or older ☐	Blind ☐
Your spouse, if claiming spouse's exemption	65 or older ☐	Blind ☐

Total number of boxes you checked ☐

If your Filing Status is:	and the number in the box above is:	Your standard deduction is:
Single	1	$4,050
	2	4,850
Married filing joint return or Qualifying widow(er) with dependent child	1	$6,100
	2	6,750
	3	7,400
	4	8,050
Married filing separate return	1	$3,375
	2	4,025
	3	4,675
	4	5,325
Head of household	1	$5,550
	2	6,350

Standard Deduction Worksheet for Dependents

Use this worksheet ONLY if someone can claim you as a dependent (Keep for your records)

If you were 65 or older or blind, check the correct number of boxes below. Then go to the worksheet.

You	65 or older ☐	Blind ☐
Your spouse, if claiming spouse's exemption	65 or older ☐	Blind ☐

Total number of boxes you checked ☐

1. Enter your **earned income** (if none, enter 0) ..... 1. _____
2. Minimum amount 2. $500
3. Compare the amounts on lines 1 and 2. Enter the **larger** of the two amounts ..... 3. _____
4. Enter the amount shown below for your filing status.
   - Single, enter $3,250
   - Married filing separate return, enter $2,725
   - Married filing jointly or Qualifying widow(er) with dependent child, enter $5,450
   - Head of household, enter $4,750

   ..... 4. _____
5. **Standard deduction.**
   a. Compare the amounts on lines 3 and 4. Enter the **smaller** of the two amounts. If under 65 and not blind, stop here. This amount is your standard deduction. Otherwise, go on to line 5b ..... 5a. _____
   b. If 65 or older or blind, multiply $800 ($650 if married filing a joint or separate return, or qualifying widow(er) with dependent child) by the total number of boxes you checked above. Enter the result ..... 5b. _____
   c. Add lines 5a and 5b. Enter the total. This is your standard deduction. ..... 5c. _____

22. Medical and Dental Expenses

Important Change for 1990

Self-employed medical insurance. The special rule that allows self-employed individuals to deduct 25% of medical insurance premiums from gross income was extended through September 1990. It was originally scheduled to expire after 1989. See ***Health Insurance Costs for Self-Employed Persons,*** later.

To deduct any medical and dental expenses, you must itemize your deductions on Schedule A (Form 1040). You must reduce the amount of your medical expenses by any reimbursement you receive for these expenses.

Medical expenses include payments you make for the diagnosis, treatment, or prevention of disease, or for treatment affecting any part or function of the body. They also include the cost of transportation for needed medical care and payments for medical insurance.

There are limits on the amount you can deduct. You can deduct only the amount of your medical and dental expenses that is more than 7.5% of your adjusted gross income shown on line 32, Form 1040. See *How to Figure Your Deduction,* later.

Whose Expenses Can You Include?

You can include medical expenses you pay for yourself and for the individuals discussed in this section.

Spouse. You can include medical expenses you paid for your spouse if you were married at the time the expenses were incurred or when you paid the bills.

Example 1. Mary incurred medical expenses before she and Bill were married. Bill paid those expenses after they were married. He can include them in figuring his medical expense deduction, even if he and Mary file separate returns.

Example 2. In Example 1, if Mary had paid her own medical bills before she and Bill were married, Bill could not include Mary's medical expenses on his separate return. Mary would include all the medical expenses she paid during the year on her separate return. If they filed a joint return, they would include the medical expenses they both paid.

Example 3. During 1990, John paid medical expenses for his wife Louise, who died in 1990. He married Belle in 1990 and they file a joint return. Because John was married to Louise when she incurred the medical expenses, he can include them in figuring his medical deduction for 1990.

Dependents. You can include medical expenses you paid for a person who was your dependent at the time the medical services were provided or the expenses were paid. You can also include medical expenses for a person you could have claimed as a dependent except that the person had gross income of $2,050 or more or had filed a joint return.

Example 1. You provided more than half the support of your 22-year-old son, including $800 medical expenses. Because he is not a student and he earned more than $2,050, you cannot claim him as a dependent. In figuring your medical expenses, you can include the $800 you paid for your son.

Example 2. You provided more than half your married daughter's support, including her medical expenses of $1,200. She and her husband file a joint return. Although you cannot claim your daughter as a dependent, you can include in your medical expenses the $1,200 you paid for her.

Adopted child. Include pre-adoption medical expenses that you paid if the child qualified as your dependent when the medical expenses were provided or when you paid those expenses.

If you pay back an adoption agency or other persons for medical expenses they paid under an agreement with you, you are considered to have paid those expenses. But if you pay back medical expenses incurred and paid before adoption negotiations began, you cannot include them as medical expenses.

Child of divorced or separated parents. If either parent can claim a child as a dependent under the rules for divorced or separated parents, each parent can include the medical expenses he or she pays for the child. See *Support Test for Divorced or Separated Parents* in Chapter 3.

Multiple support. You can include medical expenses you paid for a person for whom you meet the support test under a multiple support agreement, even if you cannot claim the person as a dependent because he or she had gross income of $2,050 or more. If you are entitled to claim a dependent under a multiple support agreement, any medical expenses paid by others who joined you in the agreement—either directly or as repayment to you—cannot be included as medical expenses either by them or by you. See *Multiple Support Agreement* in Chapter 3.

Example. You and your three brothers each provide one-fourth of your mother's total support. Under a multiple support agreement, you claim your mother as a dependent. You paid all of her medical expenses. Your brothers repaid you for three-fourths of the total amount. In figuring your medical expense deduction, you can include only one-fourth of the total paid.

However, if you and your brothers share the nonmedical support items and you separately pay all of your mother's medical expenses, you can include the amount you paid for her medical expenses in your medical expenses.

Medical Expenses

Use the checklist in this chapter as a guide to determine which medical and dental expenses you can include on Schedule A. See Publication 502, *Medical and Dental Expenses,* for information about other expenses you can include.

Medical Insurance Premiums

You can include the amount you pay for medical insurance as a medical expense. Include insurance premiums you pay for policies that cover:

- Hospitalization, surgical fees, and other medical and dental expenses,
- Prescription drugs,
- Replacement of lost or damaged contact lenses, and
- Membership in an association that gives cooperative or so-called "free-choice" medical service, or group hospitalization and clinical care.

If you have a policy that provides more than one kind of payment, you can include the premiums for the medical care part of the policy if the charge for the medical part is reasonable. The cost of the medical portion must be separately stated in the insurance contract or given to you in a separate statement.

Medicare A. Medicare A premiums you voluntarily pay to obtain basic hospital insurance are medical expenses.

Although Medicare A is part of the social security and self-employment tax, you cannot include that amount in your medical expenses.

Medicare B. Medicare B is supplementary medical insurance. Premiums you pay for Medicare B are medical expenses. If you applied for it at age 65, you can include $28.60 per month in 1990. If you were over age 65 when you first enrolled, check the information you received from the Social Security Administration to find out your premium.

Prepaid insurance. Premiums you pay before you are 65 for insurance covering medical care for yourself, your spouse, and your dependents after you reach 65 are medical care expenses. These premiums are included in your medical expenses in the year paid if they are payable:

- In equal yearly installments, or more often, and
- Paid for at least 10 years, or until you reach 65 (but not for less than 5 years).

Premiums paid for a retired employee. Under certain employer health plans, you may continue to participate in the health plan after you retire. You may either receive a cash payment for unused sick leave or have the payment applied to the cost of insurance. If you retire under such a plan, you must include the value of the unused sick leave in your income. You include the payment applied to the cost of insurance as a medical insurance premium.

If you retire under an employer health plan which provides that your employer automatically apply your unused sick leave pay to your health insurance premiums, you do not include the value of the unused sick leave in your income. You cannot include the premiums paid with unused sick leave pay as a medical expense.

Health Insurance Costs for Self-Employed Persons

If you were self-employed or a 2% shareholder (who is treated as a partner) in an S Corporation in 1990, you can deduct as a business expense on line 26 of Form 1040, up to 25% of the medical insurance premiums you paid before October 1, 1990, for periods before October 1, 1990, for yourself and your family. The balance of the remaining premiums is included with your other medical care expenses as an itemized deduction on Schedule A subject to the 7.5% limitation. For further qualifying information see Publication 502.

The 25% deduction cannot exceed the net earnings from the business in which the insurance plan is established. This deduction ended September 30, 1990. Use the following worksheet to figure your deduction.

Medical and Dental Expenses Checklist

You can include

- Prescription medicines (those requiring a prescription by a doctor for their use by an individual) and insulin
- Medical services fees (from doctors, dentists, osteopaths, optometrists, psychiatrists, acupuntrists, chiropractors, chiropodists, Christian Science practitioners, etc.)
- Special items (artifical limbs, false teeth, eyeglasses, contact lenses, hearing aids, crutches, wheelchair, etc.)
- Hospital services fees (lab work, therapy, nursing services, surgery, etc.)
- Meals and lodging provided by a hospital during medical treatment
- Psychiatric care at a speically equipped medical center (includes meals and lodging)
- Treatment at a drug or alcohol center (includes meals and lodging provided by the center)
- Special school or home for mentally or physically handicapped persons (see Publication 502)
- Birth control pills prescribed by your doctor
- Legal abortion
- Legal operation to prevent having children
- Cosmetic surgery, such as a face lift
- Expenses of an organ donor
- Oxygen equipment and oxygen
- Cost and care of guide dogs or other animals aiding the blind, deaf, and disabled
- Part of tuition fee designated for medical care
- Part of life-care fee paid to retirement home designated for medical care
- Medical and hospital insurance premiums (see discussion)
- Transportation for needed medical care (see discussion)
- Capital expenses for equipment or improvements to your home needed for medical care (see Publication 502)
- Cost of lead-based paint removal (see Publication 502)
- Wages for nursing services (see Publication 502)
- Social Security tax for worker providing medical care (see Publication 926)

You cannot include

- Medicine you buy without a prescription
- Toothpaste, toiletries, cosmetics, etc.
- Illegal operation or treatment
- Maternity clothes
- Diaper service
- Nursing care for a healthy baby
- Medical insurance included in a car insurance policy covering all persons injured in or by your car
- Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc.
- Expenses for your general health (even if following your doctor's advice) such as—
  - —Trip for general health improvement
  - —Weight loss program
  - —Program to stop smoking
  - —Household help (even if you are physically unable to do housework)
  - —Health club dues
  - —Social activities, such as dancing or swimming lessons
- Funeral, burial or cremation expenses

Worksheet for Self-Employed Health Insurance Deduction

(Keep for your records)

1.	Enter amount paid for health insurance in 1990 for you, your spouse, and dependents*	
2.	Percentage used to figure the deduction	x .25
3.	Multiply the amount on line 1 by the percentage on line 2	
4.	Enter your net profit and any other earned income** from the business under which the insurance plan is established **minus** any deduction you claim on Form 1040, lines 25 and 27	
5.	If you were a more than 2% shareholder in an S corporation, enter your wages from that corporation	
6.	Add lines 4 and 5	
7.	Multiply the amount on line 6 by 75% (.75)	
8.	Compare the amounts on lines 3 and 7 above. Enter the smaller of the two amounts here and on Form 1040, line 26. (**DO NOT** include this amount in figuring any medical expense deduction on Schedule A (Form 1040))	

* **Enter** only amounts paid prior to October 1, 1990, for health insurance periods prior to October 1,1990.

** **Earned income** includes net earnings and gains (other than capital gains) from the disposition, transfer, or licensing of property you created.

Caution. As this publication was being prepared for print, Congress was considering a proposal that would extend the self-employed health insurance deduction. For information on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes.*

Meals and Lodging

Payment for meals and lodging provided by a hospital or similar institution as a necessary part of medical care is a medical expense if the main reason for being in the hospital is to receive medical care. Include your payment for meals and lodging provided by hospitals on line 1, Schedule A (Form 1040).

You can also include in medical expenses the cost of lodging (but not meals) while away from home, even though not provided in a hospital or similar institution, if you meet **all** of the following requirements.

- The lodging is primarily for and essential to medical care.
- Medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital.
- The lodging is not lavish or extravagant under the circumstances.
- There is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount you include in medical expenses cannot exceed $50 for each night for each person. Lodging is included for a person for whom transportation expenses are a medical expense because that person is traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to $100 per night for lodging is included as a medical expense. Include your payment for these lodging expenses on line 1, Schedule A (Form 1040).

Nursing home. The cost of meals and lodging in a nursing home or a home for the aged can be included as a medical expense if the main reason for being there is to get medical care. Include the amount you pay on line 1, Schedule A.

Do not include the cost of meals and lodging if you, your spouse, or your dependent is in the home mainly for personal or family reasons. In that case, you can include as a medical expense only the part of the cost that is for medical or nursing care.

Medical trip. You cannot include the cost of your meals and lodging while you are away from home for medical treatment that you do not receive at a medical facility, or for the relief of a specific condition, even if the trip is made on the advice of your doctor.

Example. You have a heart condition. You live in an area that has cold winters, which makes your condition worse. Your doctor advises you to spend the winter in a warmer place. You and your family spend the winter in a rented house in Florida. The trip is made for a specific medical reason. You cannot include as a medical expense any of the expenses for food and lodging between your home and Florida or while you are in Florida. However, you can include in medical expenses ***your share of the transportation expenses*** between your home and Florida. You cannot include your family's transportation expenses.

Transportation

Amounts paid for transportation primarily for and essential to medical care qualify as medical expenses. Enter the amount you paid for transportation on line 1, Schedule A (Form 1040).

Include—

- Bus, taxi, train, and plane fares,
- Ambulance service,
- Car expenses,
- Transportation expenses of a parent who must go with a child to get medical care, and
- Transportation expenses of a nurse or other person who can give injections, medications, or other treatment required by a patient who is traveling to get medical care and who cannot travel alone.

Do not include—

- Transportation expenses to and from work even if your condition requires an unusual means of transportation, or
- Transportation costs if, for nonmedical reasons only, you choose to travel to another city, such as a resort area, for an operation or other medical care prescribed by your doctor.

Car expenses. You can include out-of-pocket expenses for your car, such as gas and oil. You cannot include depreciation, insurance, general repair, or maintenance expenses.

If you do not want to figure your actual expenses, you can use a standard rate of ***9 cents a mile*** for each mile you use your car for medical reasons.

Either way, you can include the cost of parking fees and tolls.

Disabled Dependent Care Expenses

Some disabled dependent care expenses may qualify as medical expenses or as work-related expenses for purposes of taking a credit for dependent care (see Chapter 33). You can use them either way as long as you do not use the same expenses to claim both a credit and a medical expense deduction.

Impairment-Related Work Expenses

Certain unreimbursed expenses may appear to be deductible as either medical or employee business expenses. Complete Form 2106, *Employee Business Expenses,* and deduct them as miscellaneous deductions on Schedule A, line 26, if they are:

- Necessary for you to do your job satisfactorily,
- For goods or services not generally needed or used in your personal activities, and
- Not specifically covered under other income tax laws.

Example. You are blind. To do your work, you must use a reader. You use the reader both during your regular working hours at your place of work and outside of your regular working hours away from your place of work. The reader's services are only for your work. You can deduct your unreimbursed expenses for the reader as an employee business expense under *Other Miscellaneous Deductions* on line 26 of Schedule A (Form 1040). See Publication 529, *Miscellaneous Deductions,* for more information about claiming the expenses of producing income.

See Publication 907, *Tax Information for Persons with Handicaps or Disabilities,* for more information on expenses that may be impairment-related work expenses.

Decedents

Expenses paid by a decedent's estate for the decedent's medical care can be treated as paid by the decedent at the time the medical services were provided, if they are paid within the one-year period beginning with the day after the date of death. This treatment applies only if the expenses are not deducted in figuring the taxable estate for federal estate tax purposes. A statement must be filed with the decedent's Form 1040 or Form 1040X on which the expenses are included as medical expenses, showing that they have not been, and will not be, claimed on the estate tax return.

See *Amended Returns* in Chapter 1 for the period in which an amended return on Form 1040X can be filed.

Example. John Smith died on June 1, 1990. His unpaid medical expenses include $1,500 incurred in 1989 and $2,000 in 1990. Mr. Smith filed his 1989 income tax return on April 16, 1990. His executor paid the $3,500 in medical expenses in January 1991.

The executor can file an amended return for 1989, treating the $1,500 medical expenses as paid in 1989. The $2,000 can be included as a medical expense on Mr. Smith's final return for 1990.

Expenses paid by a widow or widower. Expenses paid for the medical care of a decedent by the decedent's spouse are included as medical expenses in the year they are paid, whether they are paid before or after the decedent's death.

Deceased dependent. Include your payments for the medical care of a deceased dependent in the year you pay them, whether before or after the dependent's death.

How to Figure Your Deduction

To figure your medical expense deduction, complete Schedule A (Form 1040). Write in the

amounts you paid for medical and dental care expenses after you reduce these expenses by any payments received from insurance or other sources. You can deduct only your medical and dental expenses that are more than 7.5% of your adjusted gross income (line 32, Form 1040).

For an example, see *Medical and Dental Expenses (lines 1–4, Schedule A)* under *Itemized Deductions (Schedule A)* in Chapter 38.

Write the amount of your unreimbursed expenses for ***medicines and drugs*** that required a prescription, or for insulin, on line 1, Schedule A (Form 1040). Also enter on line 1 your unreimbursed expenses for doctors, dentists, nurses, hospitals, and amounts you paid for medical insurance.

Also include on line 1, Schedule A, unreimbursed expenses for hearing aids, dentures, eyeglasses, transportation, and lodging.

Separate returns. If you and your spouse do not live in a community property state and you file separate returns, each of you can include only the medical expenses you actually paid. Any medical expenses paid out of a joint checking account in which you and your spouse have the same interest are considered to have been paid equally by each of you, unless you can show otherwise.

If you and your spouse live in a community property state and file separate returns, each of you can include half of any amounts you paid for medical expenses out of community funds. If medical expenses are paid out of the separate funds of one spouse, only the spouse who paid the medical expenses can include them. For more information, see Publication 555, *Federal Tax Information on Community Property.*

When to include. You can include medical expenses only in the year you paid them (but see *Decedents,* earlier). If you pay medical expenses by check, the day you mail or deliver the check is the date of payment. If you use a "pay-by-phone" account, the date reported on the statement of the financial institution showing when payment was made is the date of payment.

If you charge medical expenses to your credit card, include the expenses in the year the charge is made. It does not matter when you actually pay the amount charged.

Reimbursements

Before figuring your deduction, reduce total medical expenses for the year by all reimbursements (repayments) received from insurance or other sources during the year. This includes payments from Medicare. It does not matter if the reimbursement is paid to you or to the doctor, hospital, etc.

Accident insurance. You must reduce your medical expenses by the part of the payments you get from an accident insurance policy that repays you for hospitalization and medical care. See *Excess reimbursement,* later, if the repayment is more than the expenses you had.

Do not reduce medical expenses by any payment you received for loss of earnings or damages for personal injury.

Excess reimbursement. If the total reimbursement you received during the year is the same as or more than your total medical expenses for the year, you cannot take a medical deduction. The following discussions explain whether you need to include excess reimbursement in income.

Premiums paid by you. If you paid the entire premium for your medical insurance or all of the cost of a similar plan, you do not include an excess reimbursement in your gross income.

Premiums paid by you and your employer. If both you and your employer contribute to your medical insurance plan and your employer's contributions are not included in your income, include in your income the part of an excess reimbursement that is from your employer's contributions.

Example. You are covered by your employer's medical insurance policy. The annual premium is $2,000. Your employer pays $600 of that amount and the balance of $1,400 is taken out of your wages. The part of any excess reimbursement you receive under the policy that is from your employer's contributions is figured as follows:

Total annual cost of policy	$2,000
Amount paid by employer	$ 600
Employer's contribution in relation to the annual cost of the policy ($600/$2,000)	30%

You must include in your gross income 30% of the excess reimbursement you received for medical expenses under the policy.

Premiums paid by your employer. If your employer or your former employer (if you are retired) pays the total cost of your medical insurance plan and your employer's contributions are not included in your income, you must report all excess reimbursements as income. See Chapter 6 for more information about whether the medical premiums paid by your employer are exempt from tax.

More than one policy. If you receive reimbursement from more than one policy and the costs of the policies are paid by both you and your employer, you must first divide the medical expense among the policies to figure the excess reimbursement from each policy. Then divide the policy costs to figure the part of any excess reimbursement that is from your employer's contribution.

Example. You are covered by your employer's health insurance policy. The annual premium is $1,200. Your employer pays $300, and the balance of $900 is deducted from your wages. You also paid the entire premium of $250 for a personal health insurance policy.

During the year you paid medical expenses of $3,600. In the same year, you were reimbursed $2,500 under your employer's policy and $1,500 under your personal policy.

You figure the part of any excess reimbursement you receive that is from your employer's contribution as follows:

Reimbursement from employer's policy	$2,500
Reimbursement from your policy	1,500
Total reimbursement	$4,000
Amount of medical expenses from your policy ($1,500/$4,000 × $3,600 total medical expenses)	$1,350
Amount of medical expenses from your employer's policy ($2,500/$4,000 × $3,600 total medical expenses)	2,250
Total medical expenses	$3,600
Excess reimbursement from your employer's policy ($2,500 − $2,250)	$ 250

Because both you and your employer contribute to the cost of this policy, you must divide the costs again to determine the excess reimbursement from your employer's contribution.

Employer's contribution in relation to the annual cost of the policy ($300/$1,200)	25%

You must report $62.50 as income from your employer's contribution. This is 25% of the excess reimbursement of $250 that is from your employer's policy.

Reimbursement in a later year. If you are reimbursed in a later year for medical expenses you deducted in an earlier year, you must report the reimbursement as income in the later year. However, do not report more than the amount you previously deducted as medical expenses. Also, do not report the reimbursement up to the amount of the deduction that did not reduce your tax for the earlier year.

If your medical expense deduction did not reduce your income tax in 1989, all or part of the reimbursement may be excluded from your income in 1990. For more information about the recovery of an amount that you claimed as an itemized deduction in an earlier year, see *Recoveries* in Chapter 13.

Medical expenses not deducted. If you did not deduct a medical expense in the year you paid it because you did not itemize deductions or because your medical expenses were not more than the 7.5% limit, do not include in income the reimbursement for this expense that you receive in a later year. However, if the reimbursement is more than the expense, see *Excess reimbursement,* earlier.

Example. In 1990, you have medical expenses of $500. You cannot deduct the $500 because it is not more than the 7.5% limit. If in a later year you are reimbursed for any of the $500 medical expenses, you do not include the reimbursement in your gross income.

Damages. If you receive an amount in settlement of a personal injury suit, the part that is for medical expenses that you deducted in an earlier year is included as income in the later year if your medical deduction in the earlier year reduced your income tax in that year. See *Reimbursement in a later year,* earlier.

Future medical expenses. If you receive an amount in settlement of a damage suit for personal injuries that is properly allocable or determined to be for future medical expenses, you must reduce any medical expenses you pay this year and in future years related to these injuries until the amount you receive in settlement has been completely used.

23. Taxes

Important Change for 1990

Self-employment tax. Beginning in 1990, if you had income from self-employment and have to pay self-employment tax, you may deduct part of that tax in figuring your adjusted gross income.

If you itemize deductions on Schedule A (Form 1040), you can deduct certain taxes you pay during your tax year.

Deductible taxes include:

- Income tax (state, local, or foreign).
- Real property (real estate) tax (state, local, or foreign).
- Personal property tax (state or local).

You can also deduct state, local, and foreign taxes, including sales taxes, not listed above, if you paid or accrued them as part of an expense in an activity for the production of income or in carrying on a trade or business. In

some cases, however, these taxes are not deducted on Schedule A, but are deducted on other schedules or forms. See *Where to Deduct*, later.

State or local taxes are those imposed by the 50 states, U.S. possessions, or any of their political subdivisions (such as a county or city), or by the District of Columbia. An Indian tribal government and any of its subdivisions that are recognized by the Secretary of the Treasury as performing substantial government functions will be treated as a state for this purpose. Therefore, any of the taxes mentioned above that are imposed by an Indian tribal government or by any of its subdivisions that have been so recognized by the Secretary are deductible.

Foreign taxes are taxes imposed by a foreign country or any of its political subdivisions.

The tax must be imposed on you. Generally, you can deduct only taxes that are imposed on you.

Property taxes. Generally, you can deduct property taxes only if you are the property owner. If real estate taxes are paid by your spouse who owns a home, they are deductible on your spouse's separate return or on your joint return.

The tax must be paid during your tax year. If you are a cash basis taxpayer, you can deduct only those taxes paid during the calendar year for which you file a return. If you pay your taxes by check, the day you mail or deliver the check is generally the date of payment. If you use a pay-by-phone account, the date reported on the statement of the financial institution showing when payment was made is the date of payment.

If you question a tax liability and use the cash method of accounting, you can deduct the tax only in the year you actually pay it. If you use the accrual method of accounting, you must use special rules for determining when you can deduct the tax liability you are questioning. See *Contested Liabilities* in Publication 538, *Accounting Periods and Methods*, for more information.

General sales taxes. You cannot deduct state and local sales tax. However, any sales tax paid or accrued on the purchase of property (not treated as an expense) is added to the cost of the property. For more information, see Chapter 15. If you have a trade or business and buy property, such as supplies, whose cost is deductible as a business expense, the sales tax on that purchase is deductible as part of the business expense.

Income Taxes

You can deduct state and local income taxes, including taxes on interest income that is exempt from federal income tax. However, you cannot deduct state and local taxes on other exempt income. For example, the part of state income tax on a cost-of-living allowance that is exempt from federal income tax is not deductible.

State and local income taxes. Deduct state and local income taxes withheld from your salary. Deduct payments made on taxes for an earlier year in the year they were withheld or paid.

Deduct estimated tax payments you make under a pay-as-you-go plan of a state or local government. However, you must have a reasonable basis for making the estimated tax payments. Any estimated state or local tax payments you make that are not reasonably determined in good faith at the time of payment are not deductible. For example, if you made an estimated state income tax payment, but the estimate of your state tax liability for the year shows that you will get a refund of the full amount of your estimated payment, then you had no reasonable basis to believe you had any additional liability to make the payment and you cannot deduct it.

Also include any part of a prior year refund of state or local income taxes that you chose to have credited to your 1990 estimated state or local income taxes. Do not reduce your deduction by either of the following:

- Any state and local income tax refund (or credit) you expect to receive for 1990, or
- Any refund of (or credit for) prior year state and local income taxes you actually received in 1990.

Refund. If you receive a refund of state or local (or foreign) income taxes in a year after the year in which you paid them, you may have to include all or part of the refund in income on line 10 of Form 1040, in the year you receive it. This includes refunds resulting from taxes that were overwithheld, not figured correctly, or figured again as a result of an amended return. However, if you did not itemize your deductions in the previous year, you do not have to include the refund in income. For a discussion of how much to include, see *Recoveries*, in Chapter 13.

Separate returns. If you and your spouse file separate state and separate federal income tax returns, you each can deduct on your federal return only the amount of your own state income tax.

If you file separate state returns and a joint federal return, you can deduct on your joint federal return the sum of the state income taxes both of you pay.

If you and your spouse file a joint state return and separate federal returns, each of you can deduct on your separate federal return part of the state income taxes. You can deduct only the amount of the total taxes that is proportionate to your gross income compared to the combined gross income of you and your spouse. But you cannot deduct more than the amount you actually paid during the year. If you and your spouse are jointly and individually liable for the full amount of the state income tax, you and your spouse can deduct on your separate federal returns the amount you each actually paid.

Employee contributions to a state disability fund. You can deduct mandatory contributions to state disability benefit funds that provide protection against loss of wages. Payments made to the following disability funds are deductible as state income taxes on Schedule A (Form 1040):

- California Nonoccupational Disability Benefit Fund
- New Jersey Nonoccupational Disability Benefit Fund
- New York Nonoccupational Disability Benefit Fund
- Rhode Island Temporary Disability Benefit Fund

Employee contributions to private or voluntary disability plans are not deductible.

Employee contributions to a state unemployment fund that covers you for the loss of wages from unemployment caused by business conditions are deductible as taxes on Schedule A (Form 1040).

Foreign income taxes. Generally, you can take either a deduction or a credit for income taxes imposed on you by a foreign country or a U.S. possession. However, you cannot take a deduction or credit for foreign income taxes paid on income that is exempt from tax under the foreign earned income exclusion or the foreign housing exclusion. For more information about the exclusions, get Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.*

Eligible foreign income taxes are either deducted on Schedule A (Form 1040) under "Other taxes," or taken as a credit on Form 1116, *Foreign Tax Credit.*

Real Estate Taxes

Deductible real estate taxes are any state, local, or foreign taxes on real property levied for the general public welfare. They generally do not include taxes charged for local benefits and improvements that increase the value of the property.

Local benefit taxes. Local benefit taxes are deductible if they are for maintenance, repair, or interest charges related to those benefits. If only a part of the taxes is for maintenance, repair, or interest, you must be able to show the amount of that part to claim the deduction. If you cannot determine what part of the tax is for maintenance, repair, or interest, none of it is deductible.

Trash and garbage pickup fees. Fees charged for trash and garbage pickup services are not taxes. However, real estate tax remains deductible even if your real estate tax statement itemizes the types of services provided by the taxing jurisdiction, such as trash collection or fire protection.

Tax surcharge charged as rent. If your landlord increases your rent in the form of a tax surcharge because of increased real estate taxes, you cannot deduct the increase as taxes.

Homeowners association charges. These charges are not deductible because they are imposed by the homeowners association, rather than the state or local government.

Tenant-shareholders in a cooperative housing corporation. You can deduct your share of the real estate taxes the corporation paid or incurred on the property. For more information, see Publication 530, *Tax Information for Homeowners.* If the corporation leases the land and buildings and pays the real estate taxes under the terms of the lease agreement, your part of the taxes is not deductible.

Purchase or sale of real estate. If you bought or sold real estate during the year, the real estate taxes must be divided between the buyer and the seller.

The buyer and the seller must divide the real estate taxes according to the number of days in the ***real property tax year*** (the period to which the tax imposed relates) that each owned the property. The seller pays the taxes up to the date of the sale, and the buyer pays the taxes beginning with the date of the sale, regardless of the lien dates under local law.

If you use the cash method of accounting and cannot deduct taxes until they are paid, and the buyer of your property is personally liable for the tax, you are considered to have paid your part of the tax imposed at the time of the sale. This lets you deduct the part of the tax to the date of sale even though you did not actually pay it.

Example 1. Dennis and Beth White's real property tax year is the calendar year, with payment due August 1. The tax on their old home, sold on May 5, was $620 and the tax on their new home, bought on May 4, was $732. Dennis and Beth are considered to have paid a proportionate share of the real estate taxes on the old home even though they did not actually pay them to the taxing authority. On the other

hand, they can claim only the proportionate share of the taxes they paid on their new property even though they paid the entire amount.

Because Dennis and Beth held the old property for 124 days (January 1 to May 4, the day before the sale), they can deduct 124/365 of $620, or $211. They owned the new home for 242 days (May 4 to December 31, including date of purchase), so their taxes on the new home are 242/365 of $732, or $485. Their real estate tax deduction for their old and new homes is the sum of $211 and $485, or $696. They will enter this amount on line 6 of Schedule A (Form 1040).

Example 2. George and Helen Brown's real property tax year is the calendar year. Real estate taxes for the ***previous year*** are assessed in their state on January 2. They become due on May 31 and October 31 of the following year. Under state law, the tax becomes a lien on May 31. The Browns bought a home on May 2, 1990. Real estate taxes for 1989 are $680. George and Helen agree to pay all taxes due after the date of purchase. They pay $340 tax on May 31, 1990, and $340 tax on October 31, 1990. Since the taxes paid in 1990 relate to 1989, the Browns cannot deduct the taxes paid but instead must add these taxes to the cost of their home. The seller adds the $680 to the amount realized on the sale and can take a $680 deduction for real estate taxes.

In January 1991, George and Helen receive their property tax statement for 1990 taxes of $752 and pay these taxes in 1991. Because George and Helen owned their new home in 1990 for 244 days (May 2 to December 31), they are entitled to a tax deduction of 244/365 of $752, or $503. The remaining $249 of taxes paid in 1991 is added to the cost of their home. The seller is entitled to a tax deduction of $249 for the 121 days the seller owned the home in 1990. The $249 also must be added to the amount realized on the sale. The seller should contact the Browns in January 1991 to get the property tax amount due and payable, as figured earlier. This information will be helpful to the seller when the seller attaches **Form 2119,** *Sale of Your Home,* to the tax return.

Delinquent (late) taxes charged to the seller, but paid by the buyer as part of the contract price, are not deductible. The buyer adds these taxes to the cost of the property.

Real estate taxes placed in escrow (put in the care of a third party). If your monthly mortgage payment includes an amount placed in escrow for real estate taxes, you cannot deduct the total of these amounts included in your payments for the year. You can deduct only the amount of the tax that the lender actually paid to the taxing authority. If the lender does not notify you of the amount of real estate tax that was paid for you, contact the lender or the taxing authority to find the proper amount to show on your return.

Married filing separate return. If you and your spouse held property as tenants by the entirety, and you file separate returns, each of you can deduct only the taxes each of you paid on the property.

Minister's and military housing allowances. If you are a minister or a member of the uniformed services and receive a housing allowance that you can exclude from income, you still can deduct all of the real estate taxes you pay on your home.

Personal Property Taxes

To qualify as a deductible personal property tax, a state or local tax must be:

1) Charged on personal property,
2) Based ***only*** on the value of the personal property, and
3) Charged on a yearly basis, even if it is collected more than once a year, or less than once a year.

A tax can be considered charged on personal property even if it is for the exercise of a privilege. For example, a yearly tax based on value qualifies as a personal property tax even if it is called a registration fee and is for the privilege of registering motor vehicles or using them on the highways.

Example. Your state charges a yearly motor vehicle registration tax of 1% of value plus 50 cents per hundredweight. You paid $32 based on the value ($1,500) and weight (3,400 lbs.) of your car. You can deduct $15 (1% × $1,500) as a personal property tax, since it is based on the value. The remaining $17 ($.50 × 34), based on the weight, is not deductible.

Expenses of Business or Producing Income

You can deduct certain taxes only if they are ordinary and necessary expenses of your trade or business or of producing income. You generally must pay these taxes (expenses) during your tax year.

However, any tax paid in connection with the purchase or sale of property must be treated as part of the cost basis of the property or, in the case of a sale, as a reduction in the amount realized. If the cost of the property is a business expense, such as the cost of supplies, any tax paid is deductible as part of the business expense.

Where to Deduct

You deduct taxes on the following schedules:

Business taxes. Taxes that you must pay in operating your business, or on your property used in your business, are generally deducted on Schedule C (Form 1040) or Schedule F (Form 1040). For more information, get Publication 535, *Business Expenses.*

Self-employment tax. For tax years beginning in 1990, you can deduct one-half of your self-employment tax. Enter the deduction you calculated for self-employment tax on line 25, Form 1040.

Taxes on property producing rent or royalty income. These taxes generally are deducted on Schedule E (Form 1040).

State and local income taxes. These taxes are deducted only on Schedule A (Form 1040), even if your only source of income is from business, rents, or royalties.

Foreign income taxes. Generally, income taxes you pay to a foreign country or U.S. possession can be claimed as an itemized deduction on Schedule A (Form 1040), or as a credit against your U.S. income tax. For more information, get Publication 514, *Foreign Tax Credit for Individuals.*

Occupational taxes. Occupational taxes that are charged at a flat rate by a locality for the privilege of working or conducting a business in the locality are deducted by self-employed individuals on Schedule C (Form 1040) or Schedule F (Form 1040). Occupational taxes paid by an employee are deducted on Schedule A (Form 1040) as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit.

Other taxes. All other deductible taxes are deducted on Schedule A (Form 1040).

Taxes You Cannot Deduct

Many federal, state, and local government taxes are not deductible.

Nondeductible federal taxes include:

Federal income taxes, including those withheld from your pay.

Social security or railroad retirement taxes withheld from your pay.

Social security and other employment taxes paid on the wages of your employee who performed domestic or other personal services (see *Employment taxes for household workers,* later).

Federal excise taxes or customs duties, unless they are connected with your business or income-producing activity.

Federal estate and gift taxes. Although these taxes are generally not deductible, you can deduct the estate tax if you must include in gross income an amount of income in respect of a decedent. In that case, the estate tax can be deducted as a miscellaneous deduction that is not subject to the 2% of adjusted gross income limit. For more information, see *Estate Tax Deduction* in Publication 559, *Tax Information for Survivors, Executors, and Administrators.*

Nondeductible state or local taxes include:

General sales taxes.

Motor vehicle taxes (however, see *Personal Property Taxes,* earlier).

Inheritance, legacy, succession, or estate taxes.

Gift taxes.

Per capita or poll taxes.

Cigarette, tobacco, liquor, beer, wine, etc., taxes.

Utility taxes.

Nondeductible fees and charges include:

Driver's licenses, car inspection fees, license plates (however, see *Personal Property Taxes,* earlier).

Dog tags, hunting licenses.

Marriage licenses.

Tolls for bridges and roads, parking meter deposits.

Fines (such as for parking or speeding), collateral deposits.

Water bills, sewer and other service charges.

Fuel adjustment charges by a municipally owned electric utility company.

Postage.

State and local taxes on gasoline, diesel, and other motor fuels. These taxes are not deductible unless the vehicles are used for business.

Taxes for improvements to property are not deductible. These include assessments for streets, sidewalks, water mains, sewer lines, public parking facilities, and similar improvements. You should increase the basis of your property by the amount of the assessment.

Transfer taxes (or stamp taxes). Transfer taxes and other taxes and charges on the sale of a personal home are not deductible. If they are paid by the seller, they are expenses of the sale and reduce the amount realized on the sale. If paid by the buyer, they are included in the cost basis of the property. If you deduct

these taxes and charges as moving expenses as explained in Chapter 27, you cannot use them either to reduce the amount realized on the sale of your home or to increase the cost basis of your new home.

Employment taxes for household workers. You cannot deduct the social security or other employment taxes you pay on the wages of a household worker. However, you may be able to include in medical or child care expenses your share of social security and other employment taxes you pay. For more information, see Chapter 22 and Chapter 33.

24. Interest Expense

Important Change for 1990

Personal interest. You can deduct only 10% of the personal interest you paid in 1990. See *Personal Interest*, later.

Important Reminder

Home mortgage interest. Home mortgage interest is fully deductible if certain requirements are met. See *Mortgage Interest*, later.

This chapter provides a brief discussion of the rules that apply to home mortgage interest. If you need more information, get Publication 936, *Limits on Home Mortgage Interest Deduction.*

Interest is an amount paid for the use of borrowed money. To be deductible, the interest you pay must reflect the true (economic) cost of the indebtedness for the payment period. This chapter, except where noted, assumes that interest paid is the true cost.

This chapter discusses the deductibility of various kinds of nonbusiness and noninvestment interest, that is, those that you report on Schedule A (Form 1040). Business interest is reported on Schedules C, E, or F.

Investment interest, although reportable on Schedule A, is subject to different rules. These rules are discussed in Publication 550, *Investment Income and Expenses.*

If you apply the proceeds of a debt to mixed uses (for example, personal and business), you have to allocate the interest on the debt to each use in figuring how and where it is deductible. See *Allocation of Interest* later or Publication 545, *Interest Expense.*

To deduct interest on a debt, you must be legally liable for that debt. You may not deduct payments you make for someone else if you are not legally liable to make them. Both the lender and the borrower must intend that the loan be repaid. In addition, there must be a true debtor-creditor relationship between the lender and the borrower.

Example 1. You lend money to your son, hoping to be repaid when he is able. He was not legally liable to pay you. No true debtor-creditor relationship was created. Therefore, your son may not deduct any interest paid.

Example 2. You cosign a note for a loan made by a bank to your son. Your son is a student. You and your son are jointly liable on the note. Since this is a personal loan, you may deduct 10% of the interest you pay on the loan in 1990.

If you use the cash method of accounting, as most people do, you must pay the interest in cash or its equivalent before you may deduct it. If you pay by check, the day you mail or deliver the check is the date of payment. If you use a pay-by-phone account, the date reported on the statement of the financial institution showing when payment was made is the date of payment. You have not paid interest if the payment is made with funds obtained from the original lender through a second loan, an advance, or other financial arrangement similar to a loan.

Example. You borrow $1,000 in September 1990, payable in 90 days at 15% yearly interest. In December 1990 you make the payment with a new note from the same lender for $1,038 due the following March. If you use the cash method of accounting, you may not deduct the interest in the year you gave the new note because you did not actually pay the interest.

If you use the accrual method of accounting, you may deduct interest over the period it accrues, regardless of when you pay it. Generally, under the accrual method, you report income when you earn it, whether or not you receive it. You deduct your expenses when you incur them, rather than when you pay them.

Interest paid in advance. If you pay interest for a period that goes beyond the end of the tax year, you must spread this interest paid in advance over the tax years to which it applies. You may deduct in each year only the interest for that year. However, see *Points*, later.

Interest You Can Deduct

Personal Interest

The following are deductible as personal interest, subject to the 10% limit, if the debt is used for personal purposes:

- Interest on a loan
- Installment plan interest
- Bank credit card interest
- Finance charges, if separately stated
- Revolving charge account interest
- Unstated interest
- Mortgage interest that is not fully deductible
- Home improvement loan (unsecured) interest
- Interest on income tax even if business related

Other Types of Interest

If the debt is not used for personal purposes, the interest may be deductible as:

- Trade or business interest—see Publication 535
- Investment interest—see Publication 550
- Passive activity interest—see Form 8582 instructions

In addition, you can deduct:

- Interest on the deferral of certain estate taxes
- Fully deductible home mortgage interest including:
  - Points paid by borrower
  - Mortgage prepayment penalty
  - Home equity loan or line of credit interest
  - Redeemable ground rents

Refunds of interest. If you receive a refund of interest in the same tax year you pay it, you must reduce your interest expense by the amount refunded to you. If the interest expense is personal interest, you should reduce the expense by the amount of the refund before applying the personal interest limits. If you receive a refund of interest you deducted in an earlier year, you generally must include the refund in income in the year you receive it. But you only need to include the amount of the deduction that reduced your tax in the earlier year.

For more information, see *Recoveries* in Chapter 13.

Items You May Not Deduct

Some interest payments are not deductible. Certain expenses similar to interest also are not deductible.

"Points" if you are a seller

Nonredeemable ground rent

Service charges (however, see *Service fees; Other Expenses* in Chapter 30)

Annual fees for credit cards

Loan fees

Credit investigation fees

Interest relating to tax-exempt income

Interest to purchase or carry tax-exempt securities

Interest to purchase or carry certain straddle positions

Premium on a convertible bond

Interest paid on a loan from a "Clifford" trust. If you are the grantor of a "Clifford" trust, and borrow funds from the trust, you may not deduct any part of the interest payments you make unless the loan is a genuine debt.

Interest to purchase or carry tax-exempt securities. You may not deduct interest on money you borrow to buy tax-exempt securities. See Publication 550.

Interest deducted in advance from a life insurance loan. If you are a cash method taxpayer, and you borrowed money on your life insurance policy, you may not deduct the interest on the loan in the following situations:

The insurance company deducted the interest in advance from the amount of the loan, or

You did not make interest payments when due and the insurance company added the interest due to the loan.

You can deduct the interest in the tax year in which you actually pay it. If you are an accrual method taxpayer, you can deduct the interest only when the liability to pay accrues.

Example. You are a cash method taxpayer and you borrow $1,000 on your life insurance policy in 1990. The insurance company pays you $950 and keeps $50 as interest paid in advance. Your first interest payment is not due until 1991. You have no interest deduction for this loan for 1990.

Single-premium life insurance, endowment, or annuity contracts. You may not deduct interest on money you borrow to buy a single-premium life insurance, endowment, or annuity contract. This includes—

1) Policies on which you pay almost all the premiums within 4 years from the date of purchase, and
2) Policies on which you deposit an amount with the insurer to pay a substantial number of future premiums.

You may not deduct interest on a loan that is used to buy stock if the collateral on the loan is a single-premium annuity contract that was purchased for cash.

Insurance premiums paid in installments. Any extra charge included in insurance premiums because you pay the premiums on a semi-annual, quarterly, or monthly basis is not deductible as interest.

Systematic borrowing on insurance. If you plan to systematically borrow part or all of the increases in the cash value of a life insurance, endowment, or annuity contract, you may not deduct interest on these loans. Under these circumstances, you also may not deduct interest on the money you borrowed to buy the insurance policy.

Rental payments. If you live in a house before your final settlement, any payments you make for that period are rent, not interest, even if the settlement papers call them interest. You may not deduct these payments.

Amortization of bond premium. There are various ways to treat the premium you pay to buy taxable bonds. See Publication 535, *Business Expense*.

Penalties. You may not deduct fines and penalties for violations of law, regardless of their nature.

Mortgage Interest

Generally, mortgage interest is any interest you pay on a loan secured by your home. This includes: a mortgage, second mortgage, a line of credit, and a home equity loan. Provided the interest is deductible home mortgage interest, you may deduct all of it.

Limit on the Deduction of Mortgage Interest

In most cases, you will be able to deduct all of your home mortgage interest. This applies to any loans secured by your main home, including first and second mortgages, home equity loans, and refinanced mortgages. Whether you can deduct all of your home mortgage interest depends on the date you took out the mortgage, the amount of the mortgage, and your use of its proceeds.

If you have any of the following mortgages, you can deduct ALL of the interest on those mortgages and report it on Schedule A (Form 1040). If one or more of your mortgages is not described below, get Publication 936, *Limits on Home Mortgage Interest Deduction*, to figure the amount of interest you can deduct.

- Mortgages you took out on or before October 13, 1987 (called grandfathered debt).
- Mortgages you took out after October 13, 1987, to buy, build, or improve your home (called home acquisition debt), plus any grandfathered debt, that totaled $1 million or less throughout 1990.
- Mortgages you took out after October 13, 1987, other than to buy, build, or improve your home (called home equity debt) that totaled $100,000 or less throughout 1990.

If you are married and file a separate return, the home acquisition debt limit is $500,000 and the home equity debt limit is $50,000.

Note. You cannot deduct this interest if you use the proceeds of the mortgage to receive tax-free income.

Determining Mortgages

To determine how to treat your mortgages, refer to the explanations of mortgages, shown above. Remember that grandfathered mortgages were taken out on or before October 13, 1987, and that home acquisition and home equity mortgages were taken out after October 13, 1987.

Refinanced mortgages. If you had a grandfathered mortgage and refinanced it after October 13, 1987, for no more than the balance of the existing mortgage, you may continue to treat it as grandfathered debt. If you refinanced for a greater amount, the part that exceeds the existing balance is a home acquisition or home equity mortgage. This amount may be a mixed-use mortgage if its uses qualify as both home acquisition and home equity debt.

If the principal of your old mortgage was not amortized over the life of the mortgage you can deduct all of the interest you pay during the life of the new mortgage. A mortgage with a final "balloon" payment is not amortized over its life or term. Any interest you pay after this time limit is personal interest. However, if the principal of the old mortgage was amortized over its life, you can deduct all of the interest paid during what would have been the life of the old mortgage.

Line-of-credit mortgages. If you had a line-of-credit mortgage on your home on October 13, 1987, and you borrowed additional amounts on this line of credit after that date, the additional amounts you borrowed are treated as home acquisition or home equity debt (or both if a mixed-use mortgage, discussed next).

Mixed-use mortgages. If you took out a new mortgage after October 13, 1987 (including refinancing for more than the amount you owed or borrowing additional amounts on a line-of-credit mortgage you had on October 13, 1987), for purposes described in both home acquisition and home equity debt above, you have a mixed-use mortgage. The mortgage proceeds used to buy, build, or improve the home are home acquisition debt and the rest of the proceeds may qualify as home equity debt.

Example. You took out a first mortgage on your home for $200,000 in 1980. In March 1990, when the home had a fair market value of $400,000, and you owed $195,000 on the mortgage, you took out a home equity loan for $120,000. You used $90,000 of the home equity loan proceeds for home improvements, and $30,000 for other purposes. You can deduct all of the interest on both mortgages. The first mortgage qualifies because it was taken out on or before October 13, 1987. The home equity loan qualifies under the dollar limits of both home acquisition and home equity debt described above. The part of the mortgage subject to the home acquisition debt dollar limit ($90,000) plus the first mortgage of $195,000 totaled less than $1 million. The part of the mortgage subject to the home equity debt dollar limit ($30,000) was less than $100,000.

Note. Additional limits apply if the total amount of all mortgages exceeds the fair market value of the home. For more information, get Publication 936.

More than one home. If you had a main home and a second home, the home acquisition and home equity debt dollar limits explained above apply to the total mortgages on both homes. Your main home is the property you live in most of the time. It may be a house, condominium, cooperative, mobile home, boat or similar property. It must provide basic living accommodations including sleeping space, toilet, and cooking facilities. Your second home is similar property which you select to be your second home.

Mortgage Interest Statement

If you paid mortgage interest of $600 or more during the year on any one mortgage, you may receive a Form 1098, *Mortgage Interest Statement*, or a similar statement. You will receive the statement if you pay interest to a person (including a financial institution and a cooperative housing corporation) in the course of that person's trade or business. A governmental unit is a person for purposes of furnishing the statement.

The statement will show the total interest you paid during the year. However, it should not show points and other prepaid interest, seller payments on a "buy-down" mortgage, or HUD payments under section 235 of the National Housing Act.

You should receive the statement by January 31, 1991. The mortgage interest information will also be sent to the IRS. If the mortgage interest is fully deductible home mortgage interest, then you deduct it on line 9a, Schedule A (Form 1040), if paid to a financial institution, or line 9b, if paid to an individual. Similarly, if the mortgage interest is not fully deductible home mortgage interest, then you may be able to deduct it as personal, investment, business, or passive activity interest, subject to the rules for those deductions.

If your home mortgage interest payments are more than the amount shown on the mortgage interest statement, you can deduct the amount of the interest that you actually paid. (However, you must meet the limits discussed earlier.) The interest must be for the tax year you are claiming the deduction.

For example, your mortgage payments are due on the first of the month. Therefore, if you make a January 1 mortgage payment in December of the year before, the interest on the January payment is for December (of the year before) and is deductible in the year paid. You must attach a statement to your tax return explaining this difference.

You may deduct only your share of the mortgage interest you paid. If your mortgage payments were subsidized by a government agency, do not deduct the amount paid for you.

If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid interest on, a mortgage that was for your home and the other person received a Form 1098 showing the interest received during 1990, attach a statement to your return showing the name and address of the person who received the form. Similarly if the interest is fully deductible home mortgage interest, then in the far left margin, next to line 9b, Schedule A, write "see attached." If you are the payer of record on a mortgage on which there are other borrowers entitled to a deduction for the interest shown on the Form 1098 you received, you must furnish the other borrowers with information about the proper distribution of the amounts shown on the form you received.

Points

The term "points" (paid by a borrower) is sometimes used to describe certain charges paid by a borrower. They are also called loan origination fees, maximum loan charges, or premium charges. If the payment of any of these charges is *only* for the use of money, it is interest.

These points are interest paid in advance and, generally, you may not deduct the full amount for points in the year paid. The prepaid interest paid as points must be spread over the life (term) of the mortgage, and is considered as paid and is deductible over that period.

Points paid on a mortgage that exceeds the limits, discussed earlier, must be allocated (see Publication 936).

Exception. You may deduct the amount you pay as points in the year paid if the loan is used to ***buy or improve your main home*** and is secured by that home.

This exception will only apply if all of the following exist:

1) The payment of points is an established business practice in the area where the loan was made,
2) The points paid did not exceed the number of points generally charged in this area, and
3) The points are paid with funds other than those obtained from your lender.

If you paid more points than generally paid in this area, your deduction is limited to the points generally charged. Any additional amount of points you paid is interest paid in advance and the deduction must be spread over the life of the mortgage.

The exception will not apply to points you pay on loans secured by your second home. For a second home, you may only deduct the points over the life of the loan.

Refinancing. Points you pay to refinance a mortgage, regardless of how you arrange to pay them, are not deductible in full in the year you pay them unless they are paid in connection with the improvement of a home. This is true even if the new mortgage is secured by your main home.

For more information on refinancing, see Publication 545, *Interest Expense.*

Points charged for specific services by the lender for the borrower's account are not interest. Examples of fees for services not considered interest are the lender's appraisal fee, preparation costs for the mortgage note or deed of trust, settlement fees, and notary fees. Points charged for services for getting a **Department of Veterans Affairs (VA)** or **Federal Housing Administration (FHA)** loan are not interest.

Expenses you pay in connection with a mortgage, such as commissions, abstract fees, and recording fees, are capital expenses. You may not deduct these expenses either as interest or as current business expenses. Add these to the basis of the property.

Example 1. Don Smith borrowed $48,000 to buy his $60,000 home. He paid the lender, in addition to interest at 13%, a loan processing fee of $1,440 (three points). None of the fee was for specific services. The charging of points was an established business practice in the area and the number of points was not more than that generally charged in the area. The $1,440 loan processing fee (points) is interest. Don may deduct it in the year of payment on line 10, Schedule A (Form 1040).

Example 2. Jan Green got a loan from a bank to buy her home. The loan was guaranteed by the Department of Veterans Affairs (VA). Jan paid the bank a loan origination fee. The fee was 1% of the amount of the loan. It was charged in addition to the maximum rate of interest permitted. The 1% loan origination fee (one point) is not interest. Jan may not deduct it.

Points paid by a seller. The term "points" also is used to describe loan placement fees that the seller may have to pay to the lender to arrange financing for the buyer. The seller may *not* deduct these amounts as interest. But these charges are a selling expense that reduce the amount realized. See Chapter 17 for information on selling your home.

Special Rules

If you sell your home, you may deduct the interest paid up to, but not including, the date of sale.

Example. John and Peggy Harris bought a new home on May 3. They sold their old home on May 5. During the year they made deductible home mortgage interest payments of $122 on the old home and $2,864 on the new home. The settlement sheet for the sale of the old home showed $4 interest for the 5-day period in May up to, but not including, the date of sale. Their mortgage interest deduction for the year is $2,990 ($122 + $2,864 + $4).

Late payment charge on mortgage payment. You may fully deduct a late payment charge if it was not for a specific service performed by your mortgage holder and it was deductible home mortgage interest.

Mortgage interest credit. If you are the holder of a qualified mortgage credit certificate that provides financing for the acquisition, qualified rehabilitation, or qualified home improvement of your main home, you may be able to take a mortgage interest credit. This credit is figured on Form 8396, *Mortgage Interest Credit.* If you take this credit, you must reduce your mortgage interest deduction by the amount of the credit.

Generally, to figure your credit, multiply the amount of interest paid during the year on the loan amount covered by the certificate by the certificate credit rate (10% to 50%) shown on your certificate. If the credit rate is more than 20%, your credit is limited to $2,000. The mortgage interest credit is discussed in Chapter 35.

Example. The mortgage interest paid on the loan amount shown on your mortgage credit certificate is $3,900. Your certificate credit rate is 30%. You reduce your mortgage interest by $1,170 ($3,900 × 30%), your allowable credit, and deduct $2,730 ($3,900 − $1,170) on line 9a, Schedule A (Form 1040).

Minister's and military housing allowance. If you are a minister or member of the uniformed services and receive a housing allowance that you may exclude from income, you may still deduct all of the deductible interest on your home mortgage.

Graduated payment mortgages (GPM). GPMs under section 245 of the National Housing Act provide that monthly payments increase every year for a number of years and then stay the same. During the early years, payments are less than the amount of interest owed on the loan. The interest that is not paid becomes part of the principal. Future interest is figured on the increased unpaid mortgage loan balance.

Subject to the applicable limits, you may deduct the interest you actually paid during the year if you are a cash method taxpayer. For example, if the interest owed is $2,551 but your payment for the year is $2,517, you may deduct $2,517. Add $34 to the loan principal.

Mortgage assistance payments. If you qualify for mortgage assistance payments under section 235 of the National Housing Act, part or all of the interest on your mortgage may be paid for you. You may not deduct any interest that is paid for you. You do not include these payments in your income. However, these payments do not reduce other deductions, such as taxes.

Redeemable ground rents. If you make annual or periodic rental payments on a redeemable ground rent, you may deduct them as mortgage interest.

Payments made to buy the lessor's entire interest in the title are not ground rents. You may not deduct them. For more information, see Publication 545.

Nonredeemable ground rent. Payments on a nonredeemable ground rent are not interest. You may deduct them as rent if they are a business expense or if they are for rental property held to produce income.

Reverse mortgage loans. A reverse mortgage loan is a loan that is based on the value of your home and is secured by a mortgage on your home. The lending institution pays you the proceeds of the loan in installments over a period of months or years. The loan agreement may provide that interest will be added to the outstanding loan balance monthly as it accrues. If you are a cash method taxpayer, you deduct the interest on a reverse mortgage loan when you actually pay it, not when it is added to the outstanding loan balance.

Mortgage prepayment penalty. If you pay off your mortgage early, you may have to pay a penalty. You may deduct that penalty as deductible home mortgage interest if it qualifies. Otherwise, you may deduct it as personal interest.

Personal Interest

You may only deduct part of any personal interest you pay. The amount you may deduct decreases each year until 1991. For 1990 you may deduct 10% of your personal interest. After 1990, you will not be allowed any deduction for personal interest.

Example. In 1990, Marian paid personal interest on her credit card balance, personal loan, and car loan. The total she paid was $1,000. Marian was entitled to deduct 10% of this interest, $100 as an itemized deduction on her 1990 tax return. For 1991 she will not be allowed any deduction for personal interest.

Personal Interest Items

The following items are personal interest and are deductible subject to the limits, discussed earlier.

Interest on income tax. Interest you pay on income taxes (whether federal, state, or local) is personal interest. This includes interest on taxes from an S corporation (in which you are a shareholder), a partnership (in which you are a partner), and your trade or business. However, interest on income tax of a corporation in which you are a shareholder is not personal interest.

Installment Plan Interest

When you buy property on the installment plan (buying on time), you may deduct 10% of your interest payments if they are separately stated or if they can be determined and proved.

Credit card finance charges. You may only deduct 10% of the finance charges added to your monthly statements. Finance charges are figured at an annual percentage rate and based on the unpaid monthly balances.

Bank credit card. You may deduct 10% of the finance charges on your bank credit card account balance if no part of the charge is a service charge, loan fee, credit investigation fee, or similar charge.

One-time charges. You may deduct as personal interest 10% of a one-time charge for each cash, check, or overdraft advance added to your bank credit card account balance.

Retail installment contract finance charges. You may deduct 10% of the separately stated finance charges figured under an annual percentage rate shown in a retail installment contract. You also may deduct any fee you are charged for prepaying the contract.

Revolving charge account finance charges. When you buy personal property such as clothing, jewelry, furniture, or appliances, on the installment plan using a revolving charge account, there is usually a separate finance charge. You may deduct 10% of the total amount of these finance charges as interest.

Example. You bought a stove for $800 and charged it to your revolving charge account. If you pay the balance within 30 days after you are billed, there is no extra charge. If you make installment payments, you will be charged a monthly finance charge of 1½% on the unpaid balance. You may deduct 10% of your total finance charges as personal interest.

Unstated interest. If you make installment payments under a contract with a term of more than a year that has a sales price of more than $3,000 and includes no interest, or only a low stated interest, you may still be able to deduct as personal interest 10% of the amount referred to as unstated interest.

See Publication 537 for information on unstated interest.

Late payment charge by a public utility. You may deduct as personal interest 10% of the late payment charge you paid, if it was not for a specific service the public utility did for you.

Below-Market Interest Rate Loans

If you receive a below-market interest rate loan, you may be able to claim an interest expense deduction in excess of any interest that you may actually have paid. The lender would have to report that amount as interest income.

A ***below-market loan*** is a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate. A below-market transaction is generally treated as an arm's-length loan in which you, as the borrower, are deemed (1) to have received a loan in exchange for a note that requires the payment of interest at the applicable federal rate, and (2) to have received an additional payment. The additional payment is treated as a gift, dividend, contribution to capital, payment of compensation, or other payment, depending on the substance of the transaction. You may have to report this payment as taxable income depending on its classification.

For these rules to apply to a below-market loan, two transactions are assumed to have taken place:

- A transfer of an amount of foregone interest from the lender to the borrower, and
- A retransfer of the foregone interest from the borrower to the lender.

Gift and demand loans. If you receive a below-market gift demand loan or other demand loan (one payable in full at any time upon the lender's demand), you are treated as receiving an additional payment (as a gift, dividend, etc.) equal to the foregone interest. You are treated as transferring the foregone interest to the lender and may, therefore, be entitled to deduct a part of that amount as interest expense. These transfers are deemed to occur annually, generally on December 31.

Foregone interest for any period is the amount of interest that would be payable for that period if interest accrued at the applicable federal rate and was payable annually on December 31, over any interest payable on the loan for such period. The applicable federal rate is set by the IRS each month in a revenue ruling. Contact an IRS office for these rates.

Term loans. If you receive a below-market term loan (one that is not a demand loan), you are treated as receiving an additional lump-sum cash payment (as a gift, dividend, etc.) on the date the loan is made. The amount of this payment is the excess of the amount of the loan over the present value of all payments due under the loan. An amount equal to this excess is treated as original issue discount. Accordingly, the original issue discount rules of section 1272 of the Internal Revenue Code apply and you may be able to claim an interest expense deduction. Original issue discount is discussed in Chapter 8.

If you receive a ***gift term loan,*** you are treated as receiving an additional amount as determined using the rules for term loans. However, the amount of foregone interest treated as transferred by you to the lender is determined using the rules for demand loans, discussed earlier.

Loans subject to the rules. The rules for below-market loans apply to:

Gift loans

Compensation-related loans

Corporation-shareholder loans

Tax avoidance loans

Other below-market loans

Exceptions. The rules for below-market loans do not apply to:

1) Gift loans between individuals if:
   a) The total outstanding amount of loans between such individuals is $10,000 or less, and
   b) The loan is used for any purpose other than the purchase or carrying of income-producing assets; or
2) Compensation-related loans or corporation-shareholder loans if:
   a) The total outstanding amount of loans between you and the lender is $10,000 or less, and
   b) The avoidance of federal tax is not a main purpose of the loan.

Special rules for gift loans between individuals that do not exceed $100,000. Foregone interest on a gift loan may be treated as being transferred from you to the lender. The amount considered transferred is limited to the amount of your net investment income (for the year). Foregone interest on a gift loan ***will not be*** treated as transferred from you to the lender, if your net investment income is $1,000 or less (for the year).

For additional information on loans not subject to the below-market loan rules, see Publication 545.

Effective dates. These rules apply to term loans made after June 6, 1984, and to demand loans outstanding after that date.

For more information, see sections 7872 of the Internal Revenue Code and 1.7872-5T of the regulations.

Rule of 78's

For loans made before 1984, a loan agreement could provide that the interest was figured under the rule of 78's. The rule of 78's is a method of allocating interest among periods during the life (term) of the loan. The rule of 78's computation failed to reflect the true cost of borrowing.

The rule of 78's may only be used for a short-term consumer loan. To qualify as a short-term consumer loan, the loan must:

1) Be for no more than 5 years,
2) Not have a balloon payment at the end,

3) Be self-amortizing (that is, the number of level payments called for in the loan agreement must reduce the loan balance to zero), and

4) Require level payments at regular intervals at least yearly.

Loan that was not a short-term consumer loan. If you had a loan in 1983 or 1984 and it was not a short-term consumer loan, you may have been able to use the simplified method to determine your interest deduction. If you did not meet the conditions for the simplified method, you had to change the way you figured and reported your interest expense by following the instructions in Revenue Procedure 84-27 or Revenue Procedure 84-28, whichever applied. Copies of these revenue procedures are available in many IRS offices. You will also need Form 3115.

Prepayment of loan. If you prepay a loan which was subject to the rule of 78's, for which you changed your method to reflect the true cost of borrowing, you may deduct as interest, subject to the limits, the difference between the final payment required under the rule of 78's method and the true cost. This amount is in addition to any amount you would otherwise be entitled to deduct as interest paid during the year.

Allocation of Interest

If the proceeds of a loan are applied to mixed uses, an allocation must generally be made to determine the amount of interest for each category. However, do not allocate home mortgage interest that is fully deductible regardless of how the funds are used.

You allocate interest (other than fully deductible mortgage interest) on a loan in the same way as the loan itself is allocated. You do this by tracing disbursements of the debt to specific uses. For details on how to do this, see Publication 545.

Where to Deduct

You must file Form 1040 to deduct any interest expense on your tax return. Where you deduct your interest expense generally depends on how you use the loan proceeds.

Deduct fully deductible home mortgage interest you paid directly, or indirectly, to financial institutions on line 9a of Schedule A (Form 1040).

Deduct fully deductible home mortgage interest you paid to an individual on line 9b. List the person's name and address in the space provided.

Deduct points on a mortgage on line 10, of Schedule A (Form 1040).

Deduct investment interest, subject to certain limits discussed in Publication 550, on line 11, Schedule A (Form 1040).

Deduct interest of a personal nature, such as interest you pay on car loans, on line 12, Schedule A (Form 1040). Put your total personal interest on line 12a. Multiply this amount by 10% and enter the result on line 12b.

Deduct interest on non-farm business loans on Schedule C (Form 1040).

Deduct interest on farm business loans on Schedule F (Form 1040).

Deduct interest on a loan for income-producing rental or royalty property that is not used in your business in Part I of Schedule E (Form 1040).

Example. You rent out part of your home and borrow money to make repairs. You may deduct only the interest payment for the rented part in Part I of Schedule E (Form 1040). Deduct the rest of the interest payment on Schedule A (Form 1040).

25. Contributions

You may deduct charitable contributions as an itemized deduction on Schedule A (Form 1040), subject to certain limits. A charitable contribution is a contribution or gift to, or for the use of, a qualified organization. This chapter discusses:

- Qualified organizations,
- Deductible and nondeductible contributions,
- Limits on deductibility,
- Recordkeeping, and
- Reporting your deduction.

Checklist of Contributions

Use the following lists for a ***quick check*** of the kinds of contributions that you may or may not deduct. More examples are found later in this chapter.

You May Deduct Contributions To:

- Churches, Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Club of America, etc.
- Veterans' groups.
- Nonprofit schools and hospitals.
- Federal, state, and local governments, if the gifts are solely for public purposes.
- Civil defense organizations.
- Public parks and recreation facilities.

You May Not Deduct As Contributions:

- Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups.
- Cost of raffle, bingo, or lottery tickets.
- Tuition.
- Value of your time or services.
- Value of blood given to a blood bank.
- Donations to homeowners associations.
- Gifts to individuals.
- Political contributions.

Qualified Organizations

Any organization can tell you if it is a qualified organization. Most qualified organizations are listed in IRS Publication 78, *Cumulative List of Organizations*. You may deduct a contribution you made to, or for the use of, the following qualified organizations.

A state, a U.S. possession (including Puerto Rico), a political subdivision of a state or possession, the United States, or the District of Columbia, if the contribution is made for public purposes only. An Indian tribal government and any of its subdivisions that are recognized by the Secretary of the Treasury as performing substantial government functions will be treated as a state for purposes of the charitable contributions deduction.

A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States. The organization must be organized and operated only for charitable, religious, educational, scientific, or literary purposes. It may also be for the prevention of cruelty to children or animals. Certain organizations that foster national or international amateur sports competition are also included.

War veterans organizations, including posts, auxiliaries, trusts, or foundations organized in the United States or its possessions.

Domestic fraternal societies operating under the lodge system, if the contribution is to be used only for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Nonprofit cemetery companies, if the contribution can be used only for the perpetual care of the cemetery as a whole, and not for a particular lot or mausoleum crypt.

Examples of qualified organizations. Qualified organizations include:

- Nonprofit volunteer fire companies.
- Civil defense organizations.
- Public parks and recreation facilities.
- Nonprofit hospitals and medical research organizations.
- Churches or other religious organizations.
- Most nonprofit educational organizations, including day care centers if substantially all the child care provided is to enable individuals (the parents) to be gainfully employed and the services are available to the general public. However, if your contribution is a substitute for tuition or other enrollment fee, it is not deductible as a charitable contribution, as explained later under *Nondeductible Contributions*.
- Utility company emergency energy programs, if the utility company is an agent for a charitable organization that assists individuals with emergency energy needs.
- Most nonprofit charitable organizations.

Deductible Contributions

Generally, you may deduct your contributions of money or property that you make to, or for the use of, qualified organizations. If you give property to a qualified organization, you generally may deduct the fair market value of the property at the time of the contribution. See *Gifts of Property*, later in this chapter.

Your deduction for charitable contributions is generally limited to 50% of your adjusted gross income, but in some cases 20% and 30% limits may apply. See *Limit on Deductions*, later.

Benefits Received

If you contribute to a charitable organization and also receive a benefit from it, you may deduct only the amount that is more than the value of the benefit you receive. If you pay more than fair market value to a qualified organization for merchandise, goods, or services, the amount you pay that is more than the value of the item may be a charitable contribution.

Example 1. You pay $75 for a dinner-dance at a church. All of the proceeds of the function go to the church. If the dinner, plus

any entertainment or other services provided, has a fair market value of $25, the excess paid, $50, is a contribution to the church.

Example 2. At a fund-raising auction conducted by a charity, you pay $600 for a week's occupancy of a house at the beach. The amount you pay is no more than the fair rental value. You have not made a deductible charitable contribution.

Athletic events. If you make a payment to or for the benefit of a college or university and, as a result, you receive the right to buy tickets for an athletic event in the athletic stadium of the college or university, you can deduct 80% of the payment as a charitable contribution.

If any part of your payment is for tickets (rather than the right to buy tickets), that part is not deductible, but 80% of the remaining part is deductible.

Example. You pay $300 annually for membership in an athletic scholarship program maintained by a university (a qualified organization). The only benefit of membership is that you are entitled to buy one season ticket to the university's home football games for a seat in a designated area of the stadium, for a stated price of $120. 80% of the $300 payment, or $240, is deductible.

Benefit performances, etc. If you pay more than fair market value to a qualified organization for charity balls, banquets, shows, sporting events, etc., you may deduct only the amount that is more than the value of the privileges or other benefits you receive.

If there is an established charge for the event, that charge will determine the value of your benefit. If there is no set charge, only that part of your payment that is more than the reasonable value of your benefit is a gift. Whether you use the tickets or other privileges has no effect on the amount you may deduct. However, if you return the ticket to the qualified organization for resale, you may deduct the amount you paid.

The fact that the ticket or other evidence of payment indicates that the payment is a "contribution" does not necessarily mean you can deduct the entire amount. If the ticket shows the price of admission and the amount of the gift, you can deduct the gift amount.

Example. You pay $40 to see a special showing of a movie for the benefit of a qualified organization. Printed on the ticket is "Contribution—$40." If the regular price for the movie is $8, your contribution is $32.

Token items. If you receive only token items (such as bookmarks, calendars, mugs, or caps) in connection with your payment, you may be able to deduct the entire payment as a charitable contribution. You must be notified by the charity that the item you received is of insubstantial value and that the payment can be deducted in full.

Dues, fees, or assessments are deductible if you pay them to qualified organizations. However, you may deduct only the amount that is more than the value of the benefits you receive. You may not deduct dues, fees, or assessments paid to country clubs and other social organizations.

Student Living With You

If you pay the costs of a student who lives in your home, you may deduct up to $50 a month of the amount you pay. The student may be foreign or American, but must not be your dependent or relative. The student must be a member of your household under a written agreement between you and a qualified organization. The purpose of the agreement must be to provide educational opportunities for the student.

You may deduct up to $50 of your expenses for each full calendar month of your tax year during which the student is:

1) A member of your household, and
2) A full-time student in the 12th or lower grade at a school located in the United States.

A period of 15 or more days in a month counts as a full calendar month for this purpose.

You may not deduct the costs of a foreign student living in your home under a mutual exchange program whereby your child will live with a family in a foreign country.

For additional information, see *Student Living With You* in Publication 526, *Charitable Contributions*.

Out-of-Pocket Expenses

You may deduct some amounts you pay in giving services to a charitable organization. However, you may not deduct the value of your time or services.

Conventions. If you are a chosen representative attending a convention of a qualified organization, you may deduct actual unreimbursed expenses for travel and transportation, including a reasonable amount for meals and lodging, while away from home overnight in connection with the convention. However, see *Travel*, later.

You may not deduct personal expenses for sightseeing, fishing parties, theater tickets, or nightclubs. You also may not deduct travel, meals and lodging, and other expenses for your spouse or children.

You may not deduct your expenses in attending a church convention if you go only as a member of your church rather than as a chosen representative. You may deduct unreimbursed expenses that are directly connected with giving services for your church during the convention.

Uniforms. You may deduct the cost and upkeep of uniforms that you must wear while performing donated services for a charitable organization if they are not suitable for everyday use.

Foster parents. If you are a foster parent (foster care provider) and have no profit motive in providing foster care, you may deduct expenses you pay that exceed any nontaxable payments you receive to provide foster care for individuals placed in your home by a charitable organization. The expenses must be amounts spent to provide support for the individual. For more information, see *Foster-care providers* under *Income Not Taxed* in Chapter 13.

Car expenses. You may deduct unreimbursed out-of-pocket expenses, such as the cost of gas and oil, that are directly related to the use of your car in giving services to a charitable organization. You may not deduct any part of general repair and maintenance expenses, depreciation, or insurance.

If you do not want to deduct your actual expenses, you may use a standard rate of ***12 cents a mile*** to figure your contribution.

You may deduct parking fees and tolls, whether you use your actual expenses or the standard rate.

Travel. You may claim a charitable contribution deduction for travel expenses while you are away from home performing services for a charitable organization only if there is ***no significant element*** of personal pleasure, recreation, or vacation in such travel. This applies whether you pay the expenses directly, or indirectly through reimbursement by the charitable organization. An arrangement whereby you make a payment to the charitable organization and the organization pays for your travel expenses is treated as a reimbursement.

The deduction will not be denied simply because you enjoy providing services to the charitable organization.

Example 1. You are a troop leader for a tax-exempt youth group and take the group on a camping trip. You may qualify to take a charitable deduction for your own travel expenses if you are on duty in a genuine and substantial sense throughout the trip, even though you enjoyed the trip. However, if you have only nominal duties relating to the performance of services for the charity, or for significant portions of the trip you are not required to render services, you may not take a charitable deduction for travel expenses.

Example 2. You sail from one island to another and spend 8 hours a day counting whales and other forms of marine life. The project is sponsored by a charitable organization. In most circumstances, no charitable deduction is allowed for the expenses you incur.

Example 3. You work on an archaeological excavation sponsored by a charitable organization for several hours each morning. The rest of the day is free for recreation and sightseeing. No charitable deduction is allowed even though you work during the morning hours.

Example 4. You spend the entire day attending a charitable organization's regional meeting. In the evening you go to the theater. You may qualify to claim your travel expenses as charitable contributions.

Daily allowance (per diem). If you provide services for a charitable organization and receive a daily allowance to cover reasonable travel expenses, including meals and lodging while away from home overnight, include in income the amount that is more than your actual travel expenses. You may deduct your necessary travel expenses that are more than the allowance.

Deductible travel expenses include:

- Air, rail, and bus transportation,
- Out-of-pocket expenses for your car,
- Taxi fares or other costs of transportation between the airport or station and your hotel,
- Lodging costs, and
- The cost of meals.

For additional information, see *Travel Expenses* in Chapter 28.

When Deductible

To deduct your contributions, you must make them in cash or other property before the close of your tax year. This applies whether you use the cash or accrual method of accounting.

Usually, you make a contribution at the time of its unconditional delivery. For example, a check that you mail to a charity is considered delivered on the date you mail it. If you use a pay-by-phone account, the date reported on the statement of the financial institution showing when payment was made is the date of payment.

The gift to a charity of a properly endorsed stock certificate is completed on the date of mailing or other delivery to the charity or to the charity's agent. However, if you give a stock certificate to your agent or to the issuing corporation for transfer to the name of the charity, your gift is not completed until the date the stock is transferred on the books of the corporation.

If you issue and deliver a promissory note to a charitable organization as a contribution, it is not a contribution until you make the note payments. Similarly, if you grant an option to

buy real property at a bargain price to a charitable organization, no deduction is allowed until the organization exercises the option.

If you make a contribution with borrowed funds, a deduction is allowed in the year you make the contribution, regardless of when you repay the loan. Contributions charged on your bank credit card are deductible in the year you make the charge.

Nondeductible Contributions

This section provides information about a number of contributions that are not deductible.

Nonqualified organizations. Some organizations are not qualified to receive tax-deductible contributions. Contributions to the following organizations, for example, are not deductible:

- Chambers of commerce and other business leagues or organizations,
- Civic leagues,
- Communist organizations,
- Country clubs and other social clubs,
- Homeowners associations,
- Most foreign organizations, and
- Political organizations and candidates.

Appraisal fees that you pay to find the fair market value of donated property are not deductible as contributions. You may claim them, subject to the 2% of adjusted gross income limit, as miscellaneous deductions on Schedule A (Form 1040). See Chapter 30.

Blood donated to the Red Cross or to blood banks is not deductible.

Child care expenses that you pay for the care of your children while you perform services for a qualified organization are not deductible.

Contributions to a fraternal society are not deductible if they are used to pay sickness or burial expenses of members.

Contributions used to influence legislation are not deductible. Even if an organization is a qualified organization, no deduction is allowed for contributions to the organization that are earmarked for use in, or in connection with, attempting to influence the general public on legislative matters, elections, or referenda.

Direct contributions made to a foreign organization are not deductible. However, you may deduct contributions to a U.S. organization that transfers funds to a charitable foreign organization if the U.S. organization controls the use of the funds, or if the foreign organization is only an administrative arm of the U.S. organization.

Exception. Under an income tax treaty with Canada, you may be able to deduct contributions to certain Canadian charitable organizations. See Publication 597, *Information on the United States-Canada Income Tax Treaty*, for information on how to figure your deduction.

Direct contributions to needy or worthy individuals are not deductible. The contributions must be made to or for the use of a qualified organization and not earmarked by you for the use of a specific person.

Donation of use of property. If you permit a charitable organization to use your property, you may not deduct the value of its use. For example, you may not deduct the value of the use of your land by a church for a picnic. However, see *Partial interest in property*, later.

Dues to labor unions are not charitable contributions. You may deduct them as a miscellaneous expense, subject to the 2% of adjusted gross income limit, on Schedule A (Form 1040). See Chapter 30.

Payments to a hospital for care of particular patients or for services provided to such patients are not deductible as contributions, even if the hospital is operated by a city, a state, or a qualified organization.

Pre-adoption expenses of keeping a child in your home before the child is adopted may not be deducted as a contribution. However, you may be able to claim an exemption for the child. See *Adoption* in Chapter 3.

Raffles, bingo, etc. You may not deduct as charitable contributions amounts you pay to a charitable organization to buy raffle tickets or to play bingo or other games of chance. They are gambling losses, which may be deducted as an itemized deduction only to the extent of gambling winnings. See Chapter 30.

Sustainer's gift to retirement home. You may not deduct the sustainer's gift you pay when being admitted to a retirement home operated by a qualified organization. Generally, such a gift entitles you to the benefit of occupying a certain type of apartment.

Tuition, or amounts you pay instead of tuition, are not deductible as contributions, even if they are paid for children who attend parochial schools or qualifying nonprofit day care centers. A fixed amount, designated as a "donation," that is required to be paid to a private school in addition to the tuition fee as a condition of enrollment is not deductible.

Gifts of Property

If you donate property to a qualified organization, you generally may deduct the fair market value of the property at the time of the contribution. However, if the property has increased in value, you may have to make some adjustments. See *Giving Property That Has Increased in Value*, later.

For information about the records you must keep and the information you must furnish with your return if you donate property, see *Recordkeeping and How to Report*, later.

Partial interest in property. Generally, no deduction is allowed for a charitable contribution, not made by a transfer in trust, of less than your entire interest in property. A contribution of the right to use property is a contribution of less than your entire interest in that property and is not deductible. For exceptions and more information, see *Partial Interest in Property* in Publication 561.

Future interests in tangible personal property. You may deduct the value of a charitable contribution of a future interest in tangible personal property only after all intervening interests in and rights to the actual possession or enjoyment of the property have either expired or been turned over to someone other than yourself or a related party or a related organization.

A future interest is any interest that is to begin at some future time, regardless of whether it is designated as a future interest under state law.

Determining Fair Market Value

This section discusses general guidelines for determining the fair market value (FMV) of various types of donated property. Fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the necessary facts. A more comprehensive discussion can be found in Publication 561, *Determining the Value of Donated Property*.

Used clothing and household goods. Generally, the fair market value of used clothing and household goods is far less than its original cost.

For used clothing, you should claim as the value the price that buyers of used items actually pay in used clothing stores, such as consignment or thrift shops.

See *Household Goods* in Publication 561 for information on the valuation of household goods, such as furniture, appliances, and linens.

Cars, boats, and aircraft. If you donate a car, boat, or aircraft, its fair market value must be determined.

Certain commercial firms and trade organizations publish monthly or seasonal guides, for different regions of the country, containing complete dealer sale prices or dealer average prices for recent model years. These guides also provide estimates for adjusting for unusual equipment, unusual mileage, and physical condition. The prices are not "official" and these publications are not considered an appraisal of any specific donated property. But they do provide clues for making an appraisal and suggest relative prices for comparison with current sales and offerings in your area.

Example. You donate your car to a local high school for use by their students studying automobile repair. Your credit union told you that the "blue book" value of the car is $1,600. However, your car needs extensive repairs and, after some checking, you find that you would not be able to sell it for more than $750. You may deduct $750, the *true* fair market value of the car, as a charitable contribution.

Large quantities. If you contribute a large number of the same item, fair market value is the price at which comparable numbers of the item are being sold.

Giving Property That Has Increased in Value

If you donate property with a fair market value that is more than your basis in it, you may have to reduce the fair market value by the amount of appreciation (increase in value) when you figure your deduction.

Ordinary income property. Property is ordinary income property if its sale at fair market value on the date it was contributed would have resulted in ordinary income or in short-term capital gain. Examples of ordinary income property are inventory, works of art created by the donor, manuscripts prepared by the donor, and capital assets held one year or less.

The deduction for a gift of ordinary income property is its fair market value less the amount that would be ordinary income or short-term capital gain if the property were sold at its fair market value. Generally, this rule limits the deduction to your basis in the property.

Example. You donate stock that you held for 5 months to your church. The value of the stock is $1,000, but you paid only $800 (your basis). Because the $200 of appreciation would be short-term capital gain if you sold the stock, your deduction is limited to $800 (fair market value less the appreciation).

Capital gain property. Property is capital gain property if its sale at fair market value on the date of the contribution would have resulted in long-term capital gain. It includes captial assets held more than one year, as well as certain real property and depreciable property used in your trade or business and, generally, held more than one year.

You usually may deduct a gift of capital gain property at its fair market value. However, in certain situations, the fair market value is reduced to the property's cost or other basis.

Bargain sales. A bargain sale of property to a qualified organization (a sale or exchange at less than the property's fair market value) is partly a charitable contribution and partly a sale or exchange. A bargain sale may result in a taxable gain.

For more information on donated appreciated property, see *Giving Property That Has Increased in Value* in Publication 526.

Limit on Deductions

If your total contributions for the year are 20% or less of your adjusted gross income (line 32, Form 1040), they are fully deductible (provided they otherwise qualify), and it is not necessary to figure whether the limits discussed here apply.

If your contributions are more than 20% of your adjusted gross income, the amount of your deduction may be limited to either 20%, 30%, or 50% of your adjusted gross income, depending on the type of property you give and the type of organization you give it to. Your maximum charitable contribution deduction is 50% of your adjusted gross income for the year. Adjusted gross income is not reduced by net operating loss carrybacks due to losses you have in later tax years.

The 50% limit applies to gifts (other than capital gain property deducted at fair market value) to organizations listed later under *50% limit organizations.*

The 30% limit applies to:

- Gifts ***for the use of*** any organization, and
- Gifts (other than capital gain property) to all qualified organizations other than 50% limit organizations. This includes gifts to veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private nonoperating foundations.

A special 30% limit applies to gifts of capital gain property (if deducted at fair market value) to 50% limit organizations (but see the rules for electing the 50% limit for capital gain property under *How to Figure Your Deduction*, in Publication 526).

The 20% limit applies to gifts of capital gain property to all qualified organizations other than 50% limit organizations.

50% limit organizations. The following are 50% limit organizations:

1) Churches, or conventions or associations of churches,
2) All public charities,
3) All private operating foundations,
4) Private nonoperating foundations that make qualifying distributions of 100% of contributions within 2½ months following the year they receive the contribution, and
5) Certain private foundations whose contributions are pooled in a common fund, the income and principal of which are paid to public charities.

The organization will be able to tell you if the contributions you make to it qualify for the 50% limit.

If you have contributed amounts that are subject to a 20% or a 30% limit, see *Limit on Deductions* in Publication 526 for more information.

Carryovers. You may carry over your contributions that you are not able to deduct in the current year because they exceed your adjusted gross income limit. You may deduct the excess in each of the next 5 years until it is used up, but not beyond that time. For more information, see *Carryovers* in Publication 526.

Recordkeeping and How to Report

You are required to keep records to prove the amount of the cash and noncash contributions you make during the year. The kind of records you must keep depends on the amount of your contributions and whether they are cash or noncash contributions.

Cash contributions. If you make a charitable contribution of money, you must keep one of the following for each contribution you make:

1) A canceled check,
2) A receipt (or a letter or other written communication) from the charitable organization showing the name of the organization, the date of the contribution, and the amount of the contribution, or
3) Other reliable written records that include the information described in (2). Records may be considered reliable if they are of a contemporaneous nature, if you regularly keep records, or if, in the case of small donations, you have items such as buttons, tokens, or emblems that are given to contributors.

Form 1040. Enter on line 14, Schedule A (Form 1040), the contributions you made in cash or by check (including out-of-pocket expenses).

Enter on line 15, Schedule A (Form 1040), your contributions other than cash or check.

Noncash contributions. The records you must keep and the forms you must file depend on whether your deductions for contributions of property other than money total:

1) $500 or less,
2) Over $500 but not more than $5,000, or
3) Over $5,000.

Deductions of $500 or less. If you make a noncash contribution, you must get and keep a receipt from the charitable organization showing:

1) The name of the charitable organization,
2) The date and location of the charitable contribution, and
3) A reasonably detailed description of the property.

A letter or other written communication from the charitable organization acknowledging receipt of the contribution and containing the information in (1), (2), and (3) will serve as a receipt. You are not required to have a receipt where it is impractical to get one. In all cases, you must keep reliable written records for each item of donated property.

Your written records must include the following:

1) The name and address of the organization that you contributed to.
2) The date and location of the contribution.
3) A description of the property in detail reasonable under the circumstances. For a security, give the name of the issuer, the type of security, and whether it is regularly traded on a stock exchange or in an over-the-counter market.
4) The fair market value of the property at the time of the contribution, and how you figured the fair market value. If it was determined by appraisal, keep a signed copy of the appraisal.
5) The cost or other basis of the property if you must reduce its fair market value by appreciation, the amount of the reduction, and how you figured it. If you choose the 50% limit instead of the special 30% limit on certain capital gain property, you must keep a record showing the years for which you made the choice, contributions for the current year, and carryovers from preceding years to which the choice applies. See *How to Figure Your Deduction* in Publication 526 for information on how to make the capital gain property election.
6) The amount you claim as a deduction for the tax year as a result of the contribution. If you contribute less than your entire interest in the property during the tax year, you must show the amount you claimed as a deduction in any earlier years for contributions of other interests in this property. You must also include the name and address of each organization to which you contributed the other interests, the place where any such tangible property is located or kept, and the name of the person who has possession of the property, if it is someone other than the organization to which you contributed.
7) The terms of any conditions attached to the gift of property.

If the gift was a "qualified conservation contribution," your records must also include the fair market value of the underlying property before and after the gift, the type of legal interest donated, and the conservation purpose furthered by the gift. See *Qualified conservation contribution* in Publication 561 for more information.

Deductions over $500. You are required to give additional information if you claim a deduction over $500 for noncash charitable contributions. In addition, you must file **Form 8283,** *Noncash Charitable Contributions.* See *Recordkeeping and How to Report* in Publication 526 for more information.

26. Nonbusiness Casualty and Theft Losses

As a result of hurricanes, earthquakes, tornadoes, fires, vandalism, car accidents, floods, and similar events, many people suffer damage to their property. When property is damaged or destroyed by an event like this, it is called a casualty. The loss you have because of a casualty may be deductible on your federal income tax return. If your property is stolen, you may have a deductible theft loss. You must file Form 1040 and itemize your deductions on Schedule A (Form 1040) to be able to claim a casualty or theft loss of nonbusiness property. You cannot claim these losses if you file Form 1040A or Form 1040EZ.

You must reduce each casualty or theft loss on nonbusiness property by $100. You must further reduce the total of your casualty and theft losses for the year on nonbusiness property by 10% of your adjusted gross income. If these amounts are more than your losses, you do not have a casualty or theft loss deduction.

This chapter explains how and when to deduct a nonbusiness loss on your return. For information on a casualty, theft, or condemnation concerning business or income-producing property, see Chapter 25 in Publication 334, *Tax Guide for Small Business*. For information on a condemnation of your home, see *Condemnation* in Chapter 17 of this publication.

Publication 584, *Nonbusiness Disaster, Casualty, and Theft Loss Workbook*, is available to help you make a list of your damaged goods and figure your loss. That publication can serve as an inventory of your personal goods. It includes schedules to help you figure the loss on your home and its contents, and on your motor vehicles.

Condemnations. You may have a gain or loss when your property is condemned or disposed of under the threat of condemnation and you receive other property or money in payment. Condemnation is the process by which private property is legally taken, without the owner's consent, for public use by the federal government, a state government, or a political subdivision in exchange for a reasonable amount of money or property. For information on how to figure a gain or loss from a condemnation, see Chapter 17.

Loss on Deposits

A loss on deposits can occur when a bank, credit union, or other financial institution becomes insolvent or bankrupt. If you incurred such a loss, you may be able to choose how to deduct it. Instead of deducting the loss as a nonbusiness bad debt, you can choose to deduct it as a casualty loss or an ordinary loss. However, you ***cannot*** make this choice if you are at least a 1% owner, or an officer of the financial institution, or ***related*** to that owner or officer. For the definition of "related," see *Related Party Transactions*, in Publication 550, *Investment Income and Expenses*.

Choice of loss deduction. If you qualify to choose the kind of deduction as explained above, the following information may help you choose the one best for you.

A casualty loss deduction is not limited. But in figuring the deduction, the loss is reduced by $100 and 10% of adjusted gross income as explained later.

A nonbusiness bad debt is deducted as a short-term capital loss on Schedule D (Form 1040). The capital loss that can be deducted after off-setting capital gains is limited to $3,000 ($1,500 if married filing separately) for each year. For more details, see *Nonbusiness Bad Debts*, in Publication 550.

An ordinary loss deduction for a loss on deposits at a particular financial institution is limited each year to $20,000 ($10,000 if married filing separately) reduced by any expected state insurance proceeds. Further, the deduction is taken as a miscellaneous itemized deduction and is limited to amounts in excess of 2% of adjusted gross income for that year. You ***cannot*** choose the ordinary loss deduction if any part of the deposits related to the loss is ***federally insured*** (example — FDIC).

When to choose. You can choose to deduct a loss on deposits as a casualty or an ordinary loss for any year in which you can reasonably estimate how much of your deposits you have lost in an insolvent or bankrupt financial institution. The choice is generally made on the return for that year. Once you treat the loss as a casualty or ordinary loss, you cannot treat the same amount of the loss as a nonbusiness bad debt when it actually becomes worthless. Also, the choice applies to all your losses on deposits for the year in the particular financial institution. If you do not make a choice, you must wait until the actual loss is determined before you can deduct the loss as a nonbusiness bad debt. Once you make this choice, you ***cannot*** change it without permission of Internal Revenue Service.

How to report. The kind of deduction you choose for loss on deposits determines how you report your loss. If you choose to deduct the loss as a nonbusiness bad debt, you report the loss on Schedule D of Form 1040 as a short-term capital loss. If you choose to deduct your loss as an ordinary loss, you deduct the loss on line 21 of Schedule A. If you choose to report the loss as a casualty loss, you deduct the loss on Form 4684 first and then as an itemized deduction on Schedule A. See the Form 1040 instructions for more information.

Deducted loss recovered. If, in a later year, you recover an amount you deducted as a loss, you may have to include the amount recovered in your income for that year. If any part of the original deduction ***did not*** reduce your tax in the earlier year, you do not have to include that part of the recovery in your income. For more information on the taxability, see *Recoveries*, in Publication 525, *Taxable and Nontaxable Income*.

Casualty

A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual. A ***sudden*** event is one that is swift, not gradual or progressive. An ***unexpected*** event is one that is ordinarily unanticipated and one that you do not intend. An ***unusual*** event is one that is not a day-to-day occurrence and one that is not typical of the activity in which you were engaged.

A casualty can also include a government-ordered demolition or relocation of a home unsafe to use because of a disaster. For more information, see *Disaster Area Losses* in Publication 547, *Nonbusiness Disasters, Casualties, and Thefts*.

Casualty losses. Deductible casualty losses may result from a number of different causes, including—

Earthquakes
Hurricanes
Tornadoes
Floods
Storms
Volcanic eruptions
Shipwrecks
Mine cave-ins
Sonic boom
Vandalism

Fires. However, if you set the fire, you cannot deduct the resulting loss.

Car accidents. But the loss from an accident to your car is ***not*** a casualty loss if your willful negligence or willful act caused the accident, or if it was caused by the willful act or willful negligence of someone acting for you.

Other accidents. However, a loss due to the accidental breakage of articles such as glassware or china under normal conditions is not a casualty loss. Neither is a loss due to damage done by a family pet.

Nondeductible losses. There is no casualty loss deduction if the damage or destruction is caused by —

Termites or moths.

Disease. The damage or destruction of trees, shrubs, or other plants by a fungus, disease, insects, worms, or similar pests is not a deductible casualty loss. But, a sudden, unexpected, or unusual infestation by beetles or other insects may result in a casualty loss. If trees and shrubs are damaged by a storm, flood, or fire, the loss is a casualty.

Progressive deterioration. If a steadily operating cause or a normal process damages your property, it is not considered a casualty. Thus, the steady weakening of a building due to normal wind and weather conditions is not a casualty. The rust and water damage to rugs and drapes caused by the bursting of a water heater qualifies as a casualty. The deterioration and damage to the water heater itself does not qualify.

Drought. When drought causes damage through progressive deterioration, it is not a sudden event.

Theft

A theft is the unlawful taking and removing of money or property with the intent to deprive the owner of it. It includes, but is not limited to, larceny, robbery, and embezzlement. If money or property is taken as the result of extortion, kidnapping, threats, or blackmail, it may also be a theft. You need only to show that the taking of your property was illegal under the law of the state where it occurred, and that it was done with criminal intent.

Mislaid or lost property. The simple disappearance of money or property is not a theft. However, an accidental loss or disappearance of property may qualify as a casualty, if it results from an identifiable event that is sudden, unexpected, and unusual.

Example. A car door is accidentally slammed on your hand, breaking the setting of your diamond ring. The diamond falls from the ring and is never found. The loss of the diamond is a casualty.

Proof of Loss

To take a deduction for a casualty or theft loss, you must be able to show that there was actually a casualty or theft, and you must be able to support the amount you take as a deduction.

For a ***casualty*** loss, you should show:

- The type of casualty (car accident, fire, storm, etc.) and when it occurred,
- The loss was a direct result of the casualty, and
- That you were the owner of the property, or, if you leased the property from someone else, that you were contractually liable to the owner for the damage.

For a ***theft*** loss, you should show:

- When you discovered that your property was missing,
- That your property was actually stolen, and
- That you were the owner of the property.

Amount of Loss

A casualty or theft loss is generally the lesser of the following two amounts:

1) The decrease in fair market value of the property as a result of the casualty or theft, or
2) Your adjusted basis in the property before the casualty or theft.

The decrease in fair market value is the difference between the property's value immediately before and after the casualty or theft.

Fair market value. Fair market value is the price for which you could sell your property to a willing buyer, when neither of you have to sell or buy and both of you know all the relevant facts.

Adjusted basis. Adjusted basis is your basis (usually cost) increased or decreased by various events, such as improvements and casualty losses.

Theft. The fair market value of property immediately after a theft is considered to be zero, since you no longer have the property. A theft loss is the lesser of the stolen property's fair market value or adjusted basis.

Example. Several years ago, you purchased silver dollars at face value for $150. This is your adjusted basis in the property. Your silver dollars were stolen this year. The fair market value of the coins was $1,000 when stolen. However, your theft loss is $150, subject to deduction limits discussed later.

Recovered property. If you get your stolen property back, your loss is measured like a casualty loss from vandalism. That is, you must consider the actual fair market value of the property when you get it back. Your loss is the decrease in the fair market value of the property from the time it was stolen until the time it is recovered or your adjusted basis in the property before the theft, whichever is less.

Leased property. If you are liable for casualty damage to property you lease, your loss is the amount you must pay to repair the property.

Business or income-producing property. If you have business or income-producing property, and it is completely destroyed or lost because of a casualty or theft, your loss is your adjusted basis in the property minus any salvage value and any insurance or other reimbursement you receive or expect to receive. The decrease in fair market value is not considered. See Chapter 25 in Publication 334.

Separate computations. If more than one item of property was involved in a single casualty or theft, generally, you must figure the loss on each item separately. Then combine the losses to determine the total loss from that casualty or theft.

Exception for real property. In figuring a casualty loss on nonbusiness real property, the entire property (including any improvements, such as buildings, trees, and shrubs), is treated as one item. The loss is the lesser of the decrease in fair market value or the adjusted basis of the entire property.

Decrease in fair market value. To figure the decrease in fair market value because of a casualty or theft, you must make a determination of the actual price you could have sold your property for immediately before and after the loss. An appraisal is the best way to make this determination.

Items not to be considered. Generally, you should not consider the following items when attempting to establish the fair market value of your property.

Sentimental value. Do not consider sentimental value when determining your loss. If a family portrait, heirloom, or keepsake is damaged, destroyed, or stolen, you must base your loss only on its actual market value.

General decline in market value. A decrease in the value of your property because it is in or near an area that suffered a casualty, or that might again suffer a casualty, is not a casualty loss. You have such a loss only for actual casualty damage to your property. However, if your home is in a federally declared disaster area and you are ordered by your state or local government to demolish or relocate the home, you might be able to deduct a casualty loss. See *Disaster Area Losses*, in Publication 547.

The cost of protection. The cost of protecting your property against a casualty or theft is not part of a casualty or theft loss. For example, you cannot deduct what you spend on insurance or to board up your house against a storm. These expenses are only deductible by businesses as business expenses.

If you make permanent improvements to your property to protect it against a casualty or theft, the cost should be added to your basis in the property. An example would be the cost of a dike to prevent flooding.

Related expenses. The incidental expenses you have due to a casualty or theft, such as expenses for the treatment of personal injuries, for temporary housing, or for a rental car, are not part of your casualty or theft loss.

Repair and replacement costs. The cost of repairing damaged property or of replacing stolen or destroyed property is not part of a casualty or theft loss. Neither is the cost of cleaning up after a casualty.

Example. You bought a new chair 4 years ago for $300. In April, a fire completely destroyed the chair. You estimate that it would cost $500 to replace it. If you had sold the chair before the fire, you estimate that you could have gotten only $100 for it because it was 4 years old. Your loss is $100, the fair market value of the chair before the fire. It is not $500, the replacement value.

Indication of decrease in fair market value. You can use the cost of cleaning up or of making repairs after a casualty as a measure of the decrease in fair market value if you meet **all** the following conditions.

- The repairs are necessary to bring the property back to its condition before the casualty,
- The amount spent for repairs is not excessive,
- The repairs take care of the damage only, and
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty.

Restoration of landscaping. The cost of restoring landscaping to its original condition after a casualty may be an indication of the decrease in fair market value. You may be able to measure your loss by what you spend on the following:

- Removing destroyed or damaged trees and shrubs minus any salvage you receive,
- Pruning and other measures taken to preserve damaged trees and shrubs, and
- Replanting necessary to restore the property to its approximate value before the casualty.

Sources of information. It is often difficult to value your property before and after the casualty or theft. The following sources will be helpful in establishing these values.

Photographs. Photographs taken after a casualty will be helpful in establishing the condition and value of the property after it was damaged.

The costs of photographs obtained for this purpose are not a part of the loss, but can be claimed as a miscellaneous deduction subject to the 2% of adjusted gross income floor on line 21, Schedule A (Form 1040). The cost of the photographs is an expense of determining your tax liability.

Cars. Books issued by various automobile organizations may be useful in figuring the value of your car, if your car is listed in the books. You can use the books' retail values and modify them by such factors as mileage and the condition of your car to figure its value. The prices are not "official," but they may be useful in determining value and to suggest relative prices for comparison with current sales and offerings in your area. If your car is not listed in the books, you determine its value from other sources. A dealer's offer for your car as a trade-in on a new car is not usually a measure of its true value.

Appraisals. The difference between the fair market value of the property immediately before a casualty or theft and immediately afterwards should be determined by a competent appraiser. The appraiser must recognize the effects of any general market decline that may occur along with the casualty so that any deduction is limited to the actual loss resulting from damage to the property.

The appraiser should be reliable and experienced. Several factors are important in evaluating the accuracy of an appraisal:

- The appraiser's familiarity with your property before and after the casualty or theft.
- The appraiser's knowledge of sales of comparable property.
- The appraiser's knowledge of conditions in the area of the casualty.
- The appraiser's method of appraisal.

Appraisal fees. You can deduct your appraisal fees as a miscellaneous deduction subject to the 2% of adjusted gross income floor on Schedule A (Form 1040). The appraisal fee is an expense of determining your tax liability. It is not a part of the casualty loss.

Records. It is important that you have records that will prove your deduction. If you do not have the actual records to support your deduction, you can use other satisfactory evidence that is sufficient to establish your deduction.

Figuring the Loss

Generally, you must figure your loss separately for each individual item stolen, damaged, or destroyed. However, for nonbusiness real property, an entire piece of real estate is considered one item.

Real property. Real property is land, the plants and trees that grow on land, and the buildings and other structures that are placed on land. In figuring a loss to real property you own for personal use, all improvements, such as buildings and ornamental trees, are considered together. The loss is the lesser of the decrease in the fair market value of the entire property or its adjusted basis.

Example. A few years ago you bought a home in which you lived. You paid $10,000 for the land and $40,000 for the house. You also spent $2,000 for landscaping. This year your home was totally destroyed by fire. The fire also damaged the shrubbery and trees in your yard. The fire was your only casualty or theft loss this year. Competent appraisers valued the property as a whole at $75,000 before the fire, but only $15,000 after the fire. (The loss to your household furnishings is not shown in this example but would be figured separately, as explained later.) You figure your casualty loss deduction as follows:

1) Adjusted basis of the entire property (cost of land, building, and landscaping)	$52,000
2) Value of entire property before fire	$75,000

3) Value of entire property after fire	15,000
4) Decrease in fair market value of entire property	$60,000
5) Amount of loss (lesser of 1 or 4)	$52,000

Personal property. Personal property is generally any property that is not real property. If your personal property is stolen or is damaged or destroyed by a casualty, you must figure your loss separately for each item of property. The loss is the lesser of the decrease in the fair market value of the property or its adjusted basis.

Example. A fire in your home completely destroyed an upholstered chair, an oriental rug, and an antique table. You did not have fire insurance to cover your loss. (This was the only casualty or theft you had during the year.) The chair cost you $750, and you established that it had a fair market value of $500 just before the fire. The rug cost you $3,000 and had a value of $2,500 just before the fire. You bought the table at an auction for $100, before discovering it was an antique. It had been appraised at $900 before the fire. You figure your loss on each of these items as follows:

	Chair	Rug	Table
1) Basis (cost)	$ 750	$3,000	$ 100
2) Value before fire	$ 500	$2,500	$ 900
3) Value after fire	-0-	-0-	-0-
4) Decrease in value	$ 500	$2,500	$ 900
5) Loss (lesser of 1 or 4)	$ 500	$2,500	$ 100
6) Total loss			$3,100

Both real and personal property. When a casualty involves both real and personal property, you must figure the loss separately for each type of property, as discussed above. But you apply a single $100 reduction to the total loss and then you apply the 10% rule (both explained later).

Property used partly for business and partly for personal purposes. When property is owned partly for personal use and partly for business or income-producing purposes, the casualty or theft loss deduction must be figured separately for the nonbusiness portion and for the business portion. You must figure the loss separately because the portion of the loss attributed to these two categories is figured in two different ways. The $100 rule and the 10% rule (explained later) apply only to the casualty or theft of the nonbusiness property.

Deduction Limitations

After you have figured your casualty or theft loss, you must figure how much of the loss you can deduct. If your loss was to property you had for your own or your family's personal use, there are ***three limits*** on the amount you can deduct for your casualty or theft loss:

1) You must reduce your loss by any reimbursements you receive or expect to receive. See *Insurance and Other Reimbursements.*
2) You must reduce your loss by $100. See *$100 Rule,* later.
3) You must further reduce your loss by 10% of your adjusted gross income on line 32 of Form 1040. See *10% Rule,* later.

Insurance and Other Reimbursements

If your property is covered by insurance, you should file a timely insurance claim for reimbursement of a loss. Otherwise, you cannot deduct this loss as a casualty or theft loss. But the portion of the loss not covered by insurance (for example, a deductible) is not subject to this rule. Therefore, if you have a car insurance policy with a $500 deductible, the first $500 of an auto collision is not covered by insurance. It would be deductible (subject to the $100 and 10% rules discussed later) even if you do not file an insurance claim.

If you receive insurance or another type of reimbursement for your loss, you must subtract the reimbursement from the loss when you figure your deduction. You are not allowed to deduct the part of a casualty or theft loss for which you are reimbursed.

If you expect to be reimbursed, but have not yet received payment, you must still subtract the expected reimbursement from the loss. See *When to Deduct a Loss,* later.

If your reimbursement is more than your basis in the property, you have a gain. This is true even if the decrease in fair market value of the property is more than its basis. If you have a gain, you may have to pay tax on it, or you may be able to postpone reporting the gain.

See Publication 547 for more information on how to treat a gain from the reimbursement for a casualty or theft.

Other reimbursements. Insurance is the most common way to be reimbursed for a casualty or theft loss. But you may be reimbursed in some other way. The following items are considered reimbursements.

- The forgiven part of a federal disaster loan under the Disaster Relief Act (the part you do not have to pay back)
- The repayment and cost of repairs by the person who leases your property
- The court awards for damages for a casualty or theft loss (the amount you are able to collect) minus lawyers' fees and other necessary expenses
- The repairs, restoration, or cleanup provided by relief agencies
- Bonding company payment for a theft loss.

Grants, gifts, and other payments you receive to help you after a casualty are considered reimbursement *only* if they are specifically designated to repair or replace your property. If there are no conditions on how you have to use the money you receive, it is not a reimbursement even if you use it to restore your property.

Living costs. If an insurance company pays you for any of your living expenses after you lose the use of your home because of a casualty, the insurance payments are not considered a reimbursement. They do not reduce your casualty loss.

The part of insurance payments that represents a temporary increase in the living expenses you and your family have during this period does not have to be reported as income. The increase in your living expenses is the excess of your actual living expenses over your normal living expenses.

Do not include in income the payment you received for your extra expenses for renting suitable housing and for transportation, food, utilities, and miscellaneous services during the period you are unable to use your home because of the casualty. However, you must report as income the part of the insurance payments covering your normal living expenses.

Example. As a result of a fire, you vacated your apartment for a month and moved to a motel. You normally pay $525 a month rent. None was charged for the month the apartment was vacated. Your motel rent for this month was $1,200. You received $1,100 reimbursement from your insurance company for rental expenses.

The part of the insurance payment that reimburses you for the increase of your actual rent over your normal rent is $675 ($1,200 − $525). You do not include this amount in income. But you include in income the rest of the insurance received, $425 ($1,100 − $675).

If you are denied access to your home by government authorities due to a casualty or the threat of a casualty, the same rule applies.

Disaster relief. Food, medical supplies, and other forms of assistance you receive do not reduce your casualty loss unless they are replacements for lost or destroyed property. These items are not taxable income to you.

Limitation Rules

$100 Rule. A single $100 reduction applies to each individual casualty or theft, no matter how many pieces of property are involved. This rule applies after all reimbursements have been taken into account.

Generally, events closely related in origin are considered a single casualty or theft. It is a single casualty when the damage is from two or more closely related causes, such as wind and flood damage caused by the same storm. A single casualty may also damage two or more widely separated pieces of property, such as a hail storm that damages both your home and your car parked downtown.

More than one loss. If you have more than one casualty or theft loss during the tax year, you must reduce ***each*** loss by $100.

Example. Your family car was damaged in an accident in January. Your loss after the insurance reimbursement was $75. In February, your car was damaged in another accident. This time your loss after the insurance reimbursement was $90. The $100 rule must be applied to each separate casualty loss. Since neither accident resulted in a loss of over $100, you are not entitled to any deduction for these accidents.

10% Rule. You can deduct a casualty or theft loss to nonbusiness property only if your loss is more than 10% of your adjusted gross income (line 32 of Form 1040). This rule applies ***after*** you have first reduced the loss by any reimbursements and by $100. If you had more than one casualty or theft loss during the year, this 10% limit applies to the ***total*** of all your losses after each was reduced. If you have casualty or theft gains, see *Gains and losses,* later in this discussion.

Example. In June, you discovered that your house had been robbed. Your loss after insurance reimbursement was $2,000. Your adjusted gross income is $29,500. To figure your deduction, you first apply the $100 rule and then the 10% rule. Your loss after applying the $100 rule is $1,900 ($2,000 − $100). When you apply the 10% rule, you find you do not have a casualty or theft loss deduction because your loss ($1,900) is less than 10% of your adjusted gross income ($2,950).

Example. In March, you had a car accident that totally destroyed your car. You did not have collision insurance on your car, so you did not receive any insurance reimbursement. Your loss on the car was $1,200. In November, you had a fire that damaged your basement and totally destroyed the furniture, washer, dryer, and other items you had stored there. Your loss on the basement items after reimbursement was $1,700. Your adjusted gross income is $25,000. You figure your casualty loss deduction as follows:

	Car	Basement
1. Loss	$1,200	$ 1,700
2. Subtract $100 per incident	100	100
3. Loss after $100 rule	$1,100	$ 1,600
4. Total loss		$ 2,700
5. Subtract 10% of $25,000 AGI		2,500
6. Casualty loss deduction		$ 200

Gains and losses. If you had both gains and losses from casualties or thefts to nonbusiness property, special rules apply. If your total gains are less than your total losses, only the excess losses are subject to the 10% rule.

However, if your total gains are more than your total losses, the difference (gains minus losses) will be treated as capital gain on Schedule D. None of the losses will be subject to the 10% rule.

The chart, *Limitation Rules*, gives a brief explanation of how to apply the $100 rule and the 10% rule in various situations. For more detailed explanations and examples, get Publication 547.

When to Deduct a Loss

A casualty usually is apparent when it happens. A theft may not be discovered until later. This affects the year in which you may deduct a casualty or a theft loss. See the Chart, *When to Deduct a Loss*, later.

Casualty losses. Generally, you may deduct casualty losses only in the tax year in which the casualty occurred. This is true even if the damaged property is not repaired or replaced until the next year.

Loss on Deposits. When you deduct a loss on deposits in an insolvent or bankrupt financial institution depends on the type of loss you choose to take on your return. See *Loss on Deposits*, earlier.

Disaster area losses. If you have a casualty loss in a federal disaster area, you can choose to deduct the loss on your tax return for the year immediately preceding the year in which the disaster occurred. This may enable you to get an immediate refund of taxes you already paid. For more information, get Publication 547.

Theft losses. You may generally deduct a theft loss only in the year you discover your property is missing. You must be able to show there was a theft, but you do not have to know when the theft took place.

Reimbursement Claims

If there is a reasonable prospect you will be reimbursed for part or all of your loss, you must subtract the expected reimbursement to figure your loss. You must reduce your loss even if you do not receive payment until a later tax year. You are believed to have a reasonable prospect of reimbursement if you have filed suit for damages.

If you later receive less reimbursement than you expected, you include that difference as a loss with your other losses (if any) on your return for the year in which you can reasonably expect no more reimbursement.

Example. Your personal car had a fair market value of $2,000 when it was destroyed in a collision with another car in 1989. The accident was due to the negligence of the other driver. At the end of the year, there was a reasonable prospect that you would be fully reimbursed by the owner of the other car. Therefore, you do not have a deductible loss in 1989.

In January 1990, the court awards you a judgment of $2,000, but in July, it becomes apparent that you will be unable to collect any amount from the other driver. Since this is your only casualty or theft loss, you can deduct the loss in 1990 that is more than $100 and 10% of your 1990 adjusted gross income.

If you later receive more reimbursement than you expected, you may have to report the difference as income. If you have already taken a deduction for a casualty or theft loss in one year, and then in a later year you receive reimbursement, you must include it in your income for the later year to the extent your deduction reduced your tax for the earlier year.

However, if any part of your original deduction for the loss did not actually lower your tax, you do not include that part of the reimbursement in your income. You **do not** refigure your tax for the year you claimed the deduction. For more information, see *Recoveries* in Chapter 13.

Note. If the total of all the reimbursements you receive is ***more than your adjusted basis*** in the destroyed or stolen property, you will have a gain on the casualty or theft rather than a loss. Get Publication 547 for more information on how to treat a gain from the reimbursement of a casualty or theft.

Worksheet. Publication 525, *Taxable and Nontaxable Income*, has a worksheet for you to use when only part of your original deduction reduced your tax in the earlier year.

LIMITATION RULES

Under these rules, a loss means a casualty or theft loss to nonbusiness property after any reimbursement.

	$100 Rule	10% Rule
Definition of Rule	The first $100 of a casualty or theft loss is not allowed when figuring your deduction. Apply this rule after you account for any reimbursements.	You can deduct your loss only if the loss is more than 10% of your adjusted gross income from line 32 of Form 1040. Apply this rule after you reduce your loss by any reimbursements and by $100 (the $100 rule).
Single Event	For each casualty or theft, apply only one reduction of $100, even if many pieces of property are affected.	Does not apply to each event, but does apply to the total for the year.
More Than One Loss (during your tax year)	You must reduce each loss by $100.	You must reduce the total of all your losses (after you subtract $100 from each loss) by 10% of your adjusted gross income.
More Than One Person (Exception: A husband and wife filing a joint return.)	When two or more people have losses from the same casualty or theft, apply the $100 rule separately to each person.	When two or more persons have losses from the same casualty or theft, apply the 10% rule separately to each person.
Married Taxpayers (with losses from the same event)		
Filing jointly	Apply the $100 rule as if you were one person.	Apply the 10% rule as if you were one person.
Filing separately	Apply the $100 rule separately to each spouse.	Apply the 10% rule separately to each spouse.
	Note: Each spouse can deduct only half of the loss on their separate return if the property is jointly owned. But if one spouse owns the property separately, only the owner can deduct the loss.	
More Than One Owner (other than husband and wife)	Apply the $100 rule separately for each owner who has a loss on jointly owned property.	Apply the 10% rule separately for each owner who has a loss on jointly owned property.

When to Deduct a Loss

Type of Loss	Tax Year Deducted	Can You Choose Years?
Casualty losses	Year loss occurred	No
Loss of deposits		
Casualty loss	Year loss occurred	No
Bad debt	Year deposits are totally worthless	No
Ordinary loss	Year a reasonable estimate can be made	No
Federal disasters	Year either the disaster occurred or the year immediately before the disaster	Yes
Thefts	Year of discovery of the theft	No

If you receive exactly the reimbursement you expected to receive, you might not have any amount to include in your income or any loss to deduct.

Example. In December 1989, you had a collision while driving your personal car. Repairs to the car cost $950. You had $100 deductible collision insurance. Your insurance company agreed to reimburse you for the rest of the damage. As a result of your expected reimbursement from the insurance company, you do not have a casualty loss deduction in 1989.

Due to the $100 rule, you cannot deduct the $100 the insurance company did not reimburse you. When you receive the $850 from the insurance company in 1990, you do not have to report it as income.

Recovered property is your property that was stolen and later returned to you. If you recovered property after you have already taken a theft loss deduction, you must refigure your loss by:

1) Comparing the property's adjusted basis (explained under *Amount of Loss*, earlier) to its decrease in value from the time it was stolen until the time it was recovered,
2) Taking the lower of these amounts, subtracting any reimbursements (such as insurance) you received, and
3) Subtracting $100 and 10% of your AGI of the loss year.

This is your refigured loss. If this amount is less than the amount you deducted for the loss, you generally have to report the difference as income in the recovery year. But report the difference only up to the amount that reduced your tax.

How to Report a Loss

If you have a deductible casualty or theft loss from nonbusiness property, you can claim this loss only on Schedule A (Form 1040).

Form 4684. If you have a casualty or theft on nonbusiness property, you must use Section A of Form 4684, *Casualties and Thefts*, to figure and report your gain or loss. Be sure to attach Form 4684 to your return.

You must list each item or article for which you are reporting a casualty or theft on Form 4684. If more than four items of property were stolen or damaged in a single casualty or theft, attach additional Forms 4684 or sheets following the format of lines 1 through 9 of Form 4684. If you have to figure your loss on many different personal and household items, you may want to use the worksheets in Publication 584. Copies of these worksheets can be used in place of additional Forms 4684.

If you had more than one casualty or theft during the year, you must complete lines 1 through 12 on separate Forms 4684 for each casualty or theft. Use only one Form 4684 for lines 13 through 18.

Loss. If you have only losses from nonbusiness property, transfer the amount from line 18 of Section A, Form 4684, to line 18 of Schedule A (Form 1040). Schedule A is used to itemize deductions. If you do not itemize deductions, you ***cannot*** deduct your casualty or theft loss.

Gain. If you have only gains from nonbusiness property, this amount will be shown on line 15 of Section A, Form 4684. You may also have to complete Schedule D (Form 1040). For more information, get Publication 547.

Gains and Losses. If you have both gains and losses due to casualties in a single year, get Publication 547.

Business property. If you have a casualty or theft on business property, on property that earns you rent or royalty income, or on other income-producing property, you must use Section B of Form 4684 to figure and report your gain or loss. For more information, see Chapter 25 in Publication 334.

Adjustments to basis. After you take a casualty or theft loss deduction, you must reduce your basis in the property by the deductible loss you have taken and any insurance or other reimbursements. The result is a lower basis in the property. In some cases, this lower basis will carry over to any property you get to replace the stolen or destroyed property. See Chapter 15 for more information on basis.

Net operating loss. If your casualty or theft losses are more than your income, you may have a net operating loss. A net operating loss can be used to lower your taxes in an earlier year, allowing you to get a refund for taxes that you have already paid. Or it can be used to lower your taxes in a later year. You do not have to be in business to have a net operating loss from a casualty or theft. For more information on net operating losses, get Publication 536, *Net Operating Losses*.

27. Moving Expenses

If you changed job locations or started a new job, you may be able to deduct some of your moving expenses if you itemize your deductions on Schedule A (Form 1040). You may qualify for a deduction whether you are self-employed or an employee. However, you must meet the *Requirements*, explained later.

If you retire while living and working overseas, or if you are the survivor (spouse or dependent) of a person whose main job location at the time of death was outside the United States, you may be able to deduct your expenses of moving back to the United States. See *Retirees or Survivors* under *Requirements*, later.

Moves outside the United States. If you are a U.S. citizen or resident alien who moved outside the United States or its possessions because of your job or business, see Publication 521, *Moving Expenses*, for special rules that apply to your move.

Requirements

You can deduct a limited amount of your moving expenses if you meet the distance test and the time test, discussed later. Your move must also be closely related, both in time and place, to the start of work at your new job location.

Closely related to the start of work. In general, moving expenses incurred within one year from the date you first reported to work are considered closely related in time to the start of work at the new location. It is not necessary that you make arrangements to work before moving to a new location, as long as you actually do go to work. If you do not move within one year, you ordinarily cannot deduct the expenses unless you can show that circumstances existed that prevented the move within that time. For example, if to allow your child to complete high school in the same school, your family moved more than a year after you started work at the new location, you can deduct your otherwise allowable moving expenses.

A move is generally considered closely related in place to the start of work if the distance from your new home to the new job

location is not more than the distance from your former home to the new job location. A move that does not meet this requirement may qualify if you can show that:

- You are required to live at your new home as a condition of employment, or
- You will spend less time or money commuting from your new home to your new job.

Although a move may be considered to be closely related to the start of work, both in time and place, you are still required to meet the distance and time tests in order to be eligible for the moving expense deduction.

Home. Your home means your main home (residence). It may be a house, apartment, or condominium. It also may be a houseboat, housetrailer, or similar dwelling. Your ***former home*** means your home before you left for your new job location. Your ***new home*** means your home within the area of your new job location. Your home does not include other homes owned or kept up by you or members of your family. It also does not include a seasonal home, such as a summer beach cottage.

Distance Test

Your move will meet the distance test if your new main job location is at least 35 miles farther from your former home than your old main job location was. For example, if your old job was 3 miles from your former home, your new job must be at least 38 miles from that former home.

The distance between two points is the shortest of the more commonly traveled routes between those points. The distance test does not apply to the location of your new home.

Example. You moved to a new home less than 35 miles from your former home because you changed job locations. Your old job was 3 miles from your former home. Your new job is 40 miles from that home. Because your new job is 37 miles farther from your former home than the distance from your former home to your old job, you meet the 35-mile distance test.

First job or return to full-time work. If you go to work full time for the first time, or go back to full-time work after a substantial period of part-time work or of unemployment, your place of work must be at least 35 miles from your former home to meet the distance test.

Exception. If you are in the armed forces and you moved because of a permanent change of station, you do not have to meet the distance test. See *Members of the Armed Forces*, later.

Main job location. Your main job location is usually the place where you spend most of your working time. A new job location is a new place where you will work permanently or indefinitely rather than temporarily. If there is no one place where you spend most of your working time, your main job location is the place where your work is centered—for example, where you report for work or are otherwise required to "base" your work.

If you work for a number of employers on a short-term basis and you get work under a union hall system, such as a construction or building trades worker, your main job location is the union hall.

More than one job. If you have more than one job at any time, your main job location depends on the facts in each case. The more important factors to be considered are the total time you spent at each place, the amount of work you did at each place, and the money you earned at each place.

Time Test

To deduct your moving expenses, you also must meet one of the following time tests.

Time test for employees. If you are an employee, you must work full time for at least 39 weeks during the first 12 months after you arrive in the general area of your new job location. You do not have to work for the same employer for the 39 weeks. However, you must work full time within the same general commuting area. You do not have to work 39 weeks in a row. Whether you are employed full time depends on what is usual for your type of work in your area.

Seasonal work. If your work is seasonal, you are considered to be working full time during the off-season only if your work contract or agreement covers an off-season period and that period is less than 6 months. For example, a school teacher on a 12-month contract who teaches on a full-time basis for more than 6 months is considered a full-time employee for 12 months.

Temporary absence from work. You are considered to be working full time during any week you are temporarily absent from work because of illness, strikes, lockouts, layoffs, natural disasters, or similar causes. You are also considered to be a full-time employee during any week you are absent from work for leave or vacation that is provided for in your work contract or agreement.

Time test for self-employed persons. If you are self-employed, you must work full time for at least 39 weeks during the first 12 months ***and*** for a total of at least 78 weeks during the first 24 months after you arrive in the area of your new job location. You do not have to be self-employed in the same trade or business for the 78 weeks.

Whether you perform services full time during any week depends on what is usual for your type of work in your area.

You are self-employed if you work as the sole owner of an unincorporated business or as a partner in a partnership carrying on a business.

If you are an employee and become self-employed before satisfying the 39-week test for employees, you meet the time test if you satisfy the 78-week test for self-employed persons.

If you are self-employed and become an employee before satisfying the 78-week test, you may use the time spent as a full-time employee to satisfy the 78-week test if you cannot satisfy the 39-week test for employees.

For more information, see *Time test for self-employed persons* in Publication 521.

Joint return. If you are married and file a joint return and both you and your spouse work full time, either of you can satisfy the full-time work test. You cannot add the weeks your spouse worked to those you worked to satisfy that test.

Time test not met. You can deduct your moving expenses even if you have not met the time test by the date your 1990 return is due. You can do this if you expect to meet the 39-week test in 1991 or the 78-week test in 1992. If you do not meet the time test by then, you either must amend your 1990 return or report your moving expense deduction as other income on your Form 1040 for the year you cannot meet the test. Use Form 1040X, *Amended U.S. Individual Income Tax Return*, to amend your return.

If you do not deduct your moving expenses on your 1990 return, and you later meet the time test, you can file an amended return for 1990, taking the deduction.

Note. If your moving expenses become nondeductible because you did not meet the time test, you can use the part of these expenses that is for the sale or exchange of your former home to lower the gain on the sale of your former home. The part of these expenses that is for the purchase of your new home can be added to the basis of your new home. For more information on basis, see *Basis* in Chapter 17.

Exceptions to the Time Test

You do not have to meet the time test if one of the following applies:

1) You are in the armed forces and you moved because of a permanent change of station—see *Members of the Armed Forces*, later,
2) You moved to the United States because you retired—see *Retirees or Survivors*, later,
3) You are the survivor of a person whose main job location at the time of death was outside the United States—see *Retirees or Survivors*, later,
4) Your job at the new location ends because of disability, or
5) You are transferred for your employer's benefit or laid off other than for willful misconduct. For this exception, you must have obtained full-time employment, and you must have expected to meet the test at the time you started the job.

The time test also does not have to be met in case of death.

Note. You meet the exception in item (5) if you were required to leave the Middle East because of the crisis there.

Members of the Armed Forces

If you are a member of the armed forces on active duty and you move because of a permanent change of station, you can deduct a limited amount of your unreimbursed moving expenses. The limits are discussed later. You do not have to meet the ***distance and time tests,*** discussed earlier.

A permanent change of station includes:

- A move from your home to the area of your first post of duty when you begin active duty,
- A move from your last post of duty to your home or a nearer point in the United States, if you move within one year of ending your active duty or within the period allowed under the Joint Travel Regulations, or
- A move from one permanent post of duty to another.

If a member of the armed forces deserts, is imprisoned, or dies, a permanent change of station for the spouse or dependent includes a move to the place of enlistment, or to the member's, spouse's, or dependent's home of record, or nearer point in the United States.

If the military moves you and your spouse and dependents to or from separate locations, the moves are treated as a single move to your new main job location.

Services or reimbursements provided by government. Do not include in income the value of moving and storage services provided by the government in connection with a permanent change of station. However, if you receive reimbursements or allowances from the government that are more than your actual moving expenses, include the excess in income. If your reimbursements or allowances are less

than your actual moving expenses, do not include the reimbursements or allowances in income.

If you are required to relocate, and your spouse and dependents move to or from a different location, do not include in income reimbursements, allowances, or the value of moving and storage services provided by the government to move you, your spouse, and dependents to and from the separate locations.

Do not deduct any expenses for moving services that were provided by the government, or that were reimbursed to you, that you did not include in income.

Retirees or Survivors

If you meet the following requirements, you may be able to deduct a limited amount of your expenses to move to the United States. For this purpose, the term "United States" includes the possessions of the United States. You do not have to meet the ***time test***, discussed earlier.

Retirees. You can deduct moving expenses for a move to a new home in the United States when you permanently retire, if both your former main job location and your former home were outside the United States.

You are considered permanently retired when you cease gainful full-time employment or self-employment. If at the time you retire you intend your retirement to be permanent, you will be considered retired even though you later return to work. Your intention to retire permanently will be determined by your age and health, the customary retirement age for people who do similar work, whether you are receiving retirement payments from a pension or retirement fund, and the length of time before your return to full-time work.

Survivors. You can deduct moving expenses for a move to a home in the United States if you are the spouse or the dependent of a person whose main job location at the time of death was outside the United States. The move must begin within 6 months after the decedent's death and must be from a former home outside the United States that you lived in with the decedent at the time of death.

A move begins when:

- You contract for your household goods and personal effects to be moved to your home in the United States. The move must be completed within a reasonable time,
- Your household goods and personal effects are packed and on the way to your home in the United States, or
- You leave your former home to travel to your new home in the United States.

Deductible Moving Expenses

If you meet the *Requirements* discussed earlier, you can deduct the reasonable expenses of:

- Moving your household goods and personal effects (including certain storage expenses),
- Traveling to your new home,
- Househunting trips before you move,
- Living temporarily in the new area,
- Selling your former home and buying a new one, and
- Settling an old lease and signing a new lease.

Reasonable expenses. You can deduct only those expenses that are reasonable for the circumstances of your move. For example, the cost of traveling from your former home to your new one should be by the shortest, most direct route available by conventional transportation. If, during your trip to your new home, you make side trips for sightseeing, the additional expenses for your side trips are not deductible as moving expenses.

Travel by car. If you use your car for househunting or to take yourself, members of your household, or your belongings to your new home, you can figure your expenses by either deducting:

- Your actual expenses, such as gas and oil for your car, if you keep an accurate record of each expense, or
- 9 cents a mile if you can prove the mileage traveled.

You can deduct parking fees and tolls you paid in moving. You cannot deduct any part of general repairs, general maintenance, insurance, or depreciation.

Member of household. You can deduct moving expenses you pay for yourself and members of your household. A member of your household is anyone who has both your former and new home as his or her home. It does not include a tenant or employee, unless you can claim that person as a dependent.

Household Goods and Personal Effects

You can deduct the cost of packing, crating, and transporting your household goods and personal effects and those of the members of your household from your former home to your new one. If you use your own car to move your things, see *Travel by car*, earlier. You can include the cost of storing and insuring household goods and personal effects within any consecutive 30-day period after the day your things are moved from your former home and before they are delivered to your new one.

You can deduct any costs of connecting or disconnecting utilities required because of the moving of household goods, appliances or personal effects.

You can deduct the cost of shipping your car and household pets to your new home.

You can deduct the cost of moving household goods and personal effects from a place other than your former home only up to the amount it would have cost to move them from your former home.

You cannot deduct the cost of moving furniture you buy on the way to your new home.

Travel Expenses

You can deduct the cost of transportation, meals (see *Meal Expenses*, later), and lodging for yourself and members of your household while traveling from your former home to your new home. This includes expenses for the day you arrive. You can include any meal and lodging expenses you had in the area of your former home within one day after you could not live in your former home because your furniture had been moved. You can deduct expenses for only one trip to your new home for yourself and members of your household. However, all of you do not have to travel together. If you use your own car, see *Travel by car*, earlier.

Meal Expenses

You can deduct only 80% of the cost of meals (food and beverages) you incur during your househunting trip, while traveling to your new residence, and while staying in temporary quarters. The limit applies to your meal expenses whether or not you are reimbursed by your employer. This limit applies before all other moving expense limits.

If you are self-employed, you are subject to the 80% limit on meals.

Lavish or extravagant meals. You cannot deduct the cost of meals (food and beverages) you and your family incur during your move that are lavish or extravagant under the circumstances.

Pre-Move Househunting Expenses

Househunting expenses include the cost of transportation, meals (see *Meal Expenses*), and lodging for yourself and members of your household while traveling to and from the area of your new job and while you are there. You can deduct these expenses only if you begin your trip after you get a job in the new area, and you go primarily to look for a new place to live. Your househunting does not have to be successful to qualify for this deduction. You and members of your household can travel separately. There is no limit to the number of trips you or members of your household can take. However, see *Dollar Limits*, later. If you use your own car, see *Travel by car*, earlier.

If you are ***self-employed,*** see *Self-employed*, under *Temporary Living Expenses*, next.

Temporary Living Expenses

Temporary living expenses include only the costs of meals (see *Meal Expenses*) and lodging while occupying temporary quarters in the area of your new job. You can deduct these costs, subject to the *Dollar Limits*, discussed later, for any consecutive 30-day period after you get the job, but before you move into permanent quarters.

Self-employed. If you are self-employed, do not deduct your expenses for pre-move househunting trips or temporary living expenses unless you have made substantial arrangements to begin work at the new location. See *Self-employed* under *Deductible Moving Expenses* in Publication 521 for more information.

Home-Related Expenses

You can deduct the reasonable expenses of disposing of your former home and getting a new one.

Home sale expenses. When you sell your former home, the following qualify as moving expenses:

- Real estate commissions,
- Attorney's fees,
- Title fees,
- Escrow fees,
- "Points" or loan placement charges you are required to pay,
- State transfer taxes, and
- Similar expenses connected with the sale or exchange of your former home.

You ***cannot*** deduct as a moving expense the cost of physical improvements intended to improve the condition or appearance of your former home.

Home purchase expenses. When you buy your new home, the following qualify as moving expenses:

- Attorney's fees,
- Escrow fees,
- Appraisal fees,
- Title fees,

Moving Expense Dollar Limits

Type of Expense	Marital Status	Dollar Limits Form 3903
Household goods and personal effects (line 4, Form 3903)	Not applicable	No limit
Travel expenses (lines 5–8, Form 3903)*	Not applicable	No limit
Househunting and temporary living expenses (lines 9–13, Form 3903)*	Single	$1,500
	Married filing jointly—	
	1) Spouses shared same new home by end of tax year	$1,500
	2) Both spouses began work at new job locations but lived apart	$3,000 (limited to $1,500 each)
	Married filing separately—	
	1) Both spouses began work at new job locations and lived together	$750 each
	2) One working spouse	$1,500
	3) Both spouses began work at new job locations but lived apart	$1,500 each
Househunting and temporary living expenses; and expenses of selling and buying home (lines 13, 14, and 15, Form 3903)*.	Single	$3,000
	Married filing jointly—	
	1) Spouses shared same new home by end of tax year	$3,000
	2) Both spouses began work at new job locations but lived apart	$6,000 (limited to $3,000 each)
	Married filing separately—	
	1) Both spouses began work at new job locations and lived together	$1,500 each
	2) One working spouse	$3,000
	3) Both spouses began work at new job locations but lived apart	$3,000 each

*Meals are subject to an 80% limit.

"Points" or loan placement charges *not* representing payment or prepayment of interest, and

Similar expenses connected with the purchase of your new home.

No double benefit. The expenses of selling your former home that you include as part of your moving expense deduction cannot be used to reduce the amount realized on the sale of your former home. The expenses of buying your new home that are included in your moving expense deduction cannot be added to the basis of your new home. See Chapter 17 for information on selling and buying your home.

Unexpired lease expenses. When you end an unexpired lease on your former home, you can deduct, subject to the dollar limits:

Payments to the lessor for releasing you from the lease,

Attorney's fees,

Real estate commissions, and

Expenses, such as the difference between the rent you pay and the rent you receive from an assignee or sublessee.

Expenses of leasing a new home. When you lease a new home, you can deduct, subject to the dollar limits:

Attorney's fees, and

Commissions.

These expenses can be for leasing, subleasing, or taking an assignment of a lease. You *cannot* deduct payments or prepayments of rent. See *Security deposit*, later.

Dollar Limits

The expenses of moving household goods and traveling to your new home are not limited to any amount. However, the combined total of all your other moving expenses, including expenses of selling and buying your home and lease expenses, cannot be more than $3,000. Of the $3,000 limit, no more than $1,500 can be deducted for househunting trip expenses and temporary living expenses combined. Exceptions are explained later under *Married persons filing separate returns* and *Married persons filing a joint return.*

Homeowners. If you are a homeowner, you should claim househunting trip expenses and temporary living expenses, up to $1,500, before you claim the expenses of selling and buying your home. Within the dollar limits, you can choose to deduct any combination of these expenses. Any expenses for selling your home that you cannot deduct because of the $3,000 limit should be used to reduce the gain on the sale of your former home. Use any expenses for buying your home that you cannot deduct because of the limit to increase the basis of your new home.

Married persons filing separate returns. If both of you began work at new job locations and lived together, the dollar limit is $1,500 for each of you. No more than $750 for each of you can be deducted for househunting and temporary living expenses.

If only one of you began work at a new job location, the limit for that person is $3,000. No more than $1,500 can be deducted for househunting and temporary living expenses.

If both of you began work at new job locations, but you have not shared the same new home by the end of the tax year or made plans to do so, the limit for each of you is $3,000. No more than $1,500 for each of you can be deducted for househunting and temporary living expenses.

Example. Tim and Mary Brown are married, but separated. Tim moved from New York to Michigan. His moving expenses were $3,600 for househunting trips, temporary living expenses, and selling his home. Mary moved from New York to Washington, DC. Her moving expenses were $3,200 for househunting trips, temporary living expenses, and selling her home. Neither had more than $1,500 in expenses for househunting trips and temporary living expenses. Each can claim $3,000 on a separate return.

Married persons filing a joint return. If both of you began work at new job locations, but at the end of the tax year have not shared the same new home or made plans to do so, the limit is $6,000. No more than $3,000 can be deducted for househunting and temporary living expenses. However, of the $6,000 and $3,000 limits, each of you is limited to $3,000 and to $1,500 for househunting and temporary living expenses.

If you shared the same new home, the limit for both of you together is $3,000, of which no more than $1,500 can be deducted for househunting and temporary living expenses.

Nondeductible Expenses

You cannot deduct the following items as moving expenses:

- Home improvements to help sell your home,
- Loss on the sale of your home,
- Mortgage penalties,
- Losses from disposing of memberships in clubs,
- Any part of the purchase price of your new home,
- Real estate taxes,
- Car tags,
- Driver's license,
- Refitting carpets and draperies, and
- Storage charges except those incurred in transit and for foreign moves.

Security deposit. Do not deduct a security deposit you paid when you signed a new lease. Do not deduct a security deposit that you gave up because the vacated space needed cleaning or redecorating when you ended the lease. However, you can deduct a security deposit that you gave up if you broke the lease as a result of the move.

Temporary employment. You cannot take a moving expense deduction and a business expense deduction for the same expenses. You must determine if your expenses are deductible as moving expenses or as business expenses. For example, expenses you have for travel, meals, and lodging while temporarily working at a place away from your regular place of work are deductible as business expenses if you are considered away from home on business. Your work is considered temporary if its end can be foreseen within a reasonably short time, usually less than one year, and your main job location or post of duty does not change. See *Temporary assignment or job* in Chapter 28 for information on deducting your expenses.

How to Report

The following discussions explain how to report your moving expenses and any reimbursements or allowances you received for your move.

Form 3903. Use Form 3903, *Moving Expenses*, to report your moving expenses if your move was within or to the United States or its possessions. A filled-in Form 3903 is shown in Chapter 38.

Where to deduct. In order to claim the moving expense deduction, you must itemize your deductions on Schedule A (Form 1040). The amount of moving expenses you can deduct is shown on line 20, Form 3903. Enter this amount on line 19, Schedule A (Form 1040).

Reimbursements. Include all reimbursements of, or payments for, moving expenses in gross income for the year you receive them. If your employer paid for any part of your move, report that amount as income on line 7, Form 1040. Your employer must include the amount in Box 10, *Wages, tips, other compensation*, on your Form W–2, *Wage and Tax Statement*. A separate Form W–2 may be provided.

Allowance in kind. Include in your income the value of moving services provided by your employer to you or members of your family. Include this amount in income in the year you receive the services. If your employer paid someone to provide the services, include the amount paid in your income in the year your employer made the payment. Your employer must also include any allowance in kind in the total income on your Form W–2.

Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. Do not include in income any moving expense payments you received under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. These payments are made to persons displaced from their homes, businesses, or farms by federal projects.

Tax withholding. Your employer is not required to withhold income tax or social security tax on allowances or reimbursements for moving expenses if your employer reasonably believes that you will be able to deduct the expenses. This means that at the time your employer pays you the reimbursement or allowance, your employer reasonably believes that you will meet the distance and time tests, and that your expenses will be deductible.

For more information on tax withholding, see Publication 521.

Form 4782. Your employer must give you an itemized list of payments, reimbursements, or allowances paid to you as moving expenses. Form 4782, *Employee Moving Expense Information*, may be used for this purpose. See Publication 521 for a filled-in Form 4782.

When to deduct. Deduct your moving expenses in the year you had them or paid them. If you use the cash method of accounting, which is used by most individuals who are not self-employed, you can choose to deduct moving expenses in the year you are reimbursed by your employer if:

- You paid the expenses in a year before the year of reimbursement, or
- You paid the expenses in the year immediately after the year of reimbursement but by the due date, including extensions, for filing your return for the reimbursement year.

You can choose to deduct moving expenses in the year that you received reimbursement by taking the deduction on your return, or amended return, for that year.

Example 1. In December 1989, your employer transferred you to another city, where you still work. You are single and were not reimbursed for your moving expenses. In 1989 you paid for a househunting trip, travel to the new city, temporary living expenses, and moving your furniture. You itemized your deductions and deducted these expenses in 1989. In 1990 you paid additional temporary living expenses and certain deductible expenses of selling your home and buying a new one. You deduct these expenses in 1990 if you itemize deductions on Schedule A (Form 1040).

Some of your moving expenses are subject to the *Dollar Limits*, discussed earlier. You apply the 80% limit on your meal expenses before you apply the $1,500 moving expense limitation on househunting and temporary quarters.

The dollar limits are not separately applied to the expenses you deduct each year; they apply to the total expenses for that move. You must show on your 1990 Form 3903 the amounts you deducted on your 1989 Form 3903 that were subject to the dollar limits. If you deducted $1,000 in 1989 for househunting and temporary living expenses, you can deduct up to $500 for these expenses in 1990.

In 1989, you deducted $1,000 for househunting and temporary living expenses. In 1990, you incurred $800 for temporary living expenses ($600 for lodging and $200 for meals), $3,500 to sell your old home, and $500 to buy a new home. Your deduction for temporary living expenses in 1990 is limited to $500. This is the lesser of $500 ($1,500 limitation minus the $1,000 you deducted in 1989) or $760 ($600 lodging plus $160 (80% of your $200 meal expense)).

Your total moving expense deduction in 1990 is limited to $2,000. This is the amount of your househunting, temporary living, and qualified real estate expenses ($4,500), subject to the $3,000 limitation, minus the deduction you took in 1989 ($1,000) that was subject to the same limitation.

You must show your 1989 deduction on your 1990 Form 3903 by writing "$1,000 deducted in 1989" above lines 17 and 19.

Example 2. In December 1989, your employer transferred you to another city, where you still work. You paid for all of your moving expenses in 1989. Your employer fully reimbursed you in 1990 for your moving expenses. This reimbursement is included in your 1990 Form W–2. If you itemize deductions, you can deduct your allowable moving expenses in 1989 as an itemized deduction the year you paid them, or you can deduct them in

1990, the year of reimbursement. In either case, your total deduction is the same.

Example 3. In December 1990, your employer transferred you to another city, where you still work. You started your move in 1990 and finished it in 1991. Your employer paid you a flat amount in December 1990 to move. This amount was included in your 1990 Form W-2. You paid your 1991 expenses by the due date for filing your 1990 return. If you itemize deductions, you can deduct your 1990 moving expenses on your return for 1990 and your 1991 moving expenses on your return for 1991. Or, you can deduct all your allowable moving expenses on your return for 1990. In either case, your total deduction is the same.

28. Car Expenses and Other Employee Business Expenses

Important Change for 1990

Standard mileage rate. The standard mileage rate for 1990 is 26 cents per mile for all business miles. You are not subject to the 15,000 mile annual limit which applied in prior years. See *Standard mileage rate.*

This chapter explains business-related expenses for travel, transportation, meals, entertainment, and gifts that you can deduct on your income tax return. It also discusses the reporting and recordkeeping requirements for these expenses.

If you are an employee and have travel, transportation, meal, entertainment, or gift expenses related to your work, you may be able to deduct these expenses on your income tax return.

Outside salespersons. Outside salespersons must report their expenses in the same manner as all other employees.

General Requirements

You can deduct expenses for business-related travel, transportation, meals, entertainment, and gifts only if the expenses are both ordinary and necessary. An ordinary expense is one that is common and accepted in your field of business, trade, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be indispensable to be considered necessary.

Not reimbursed. If you are not reimbursed for these expenses, you must complete Form 2106, *Employee Business Expenses*, and itemize your deductions on Schedule A (Form 1040) to claim a deduction. You must keep records and supporting evidence to prove your expenses, as explained later under *Records.*

If your reimbursement is paid under a nonaccountable plan (defined later), the preceding paragraph applies.

Reimbursed. If you are reimbursed for these expenses, and (as required by your employer's plan) you adequately account to your employer, and return any excess reimbursements, the reimbursements will not be shown on your Form W-2. You do not need to file Form 2106 unless you want to claim other expenses.

Self-employed persons. If you are self-employed as a sole proprietor or independent contractor, deduct the allowable portion of your own business travel, and meals and entertainment expenses on line 24 of Schedule C, Part II (Form 1040). Deduct your car expenses for travel and transportation on line 10 of Part II. The amounts you reimburse or allow your employees for these expenses are also reported on line 10 or line 24 of Schedule C. Deduct your gift expenses on line 27a of Part II.

Independent contractor. If you have reimbursed travel, meal, entertainment, or gift expenses that you incurred on behalf of a client, you should provide an adequate accounting of these expenses to your client. If you do not account to your client for these expenses, you must include any reimbursements or allowances in income. You must keep adequate records of these expenses regardless of whether you account to your client for such expenses.

If you do not separately account for and seek reimbursement for meals and entertainment in connection with providing services for a client, you are subject to the 80% limit on such expenses. See *80% Limitation,* later.

Client or customer. If you are a client or customer, you are not required to keep records to prove the reimbursements or allowances you give, in the course of your business, to an independent contractor for travel or gift expenses incurred on your behalf. However, you must keep records if:

1) You reimburse the contractor for meal and entertainment expenses incurred on your behalf, ***and***
2) The contractor adequately accounts to you for these expenses.

Adequate accounting by contractor. If the contractor does adequately account to you for meal and entertainment expenses, you must keep records documenting each element of the expense, as explained later under *Records.* Use your records as proof for a deduction on your tax return. If meals and entertainment are accounted for separately, you are subject to the limit discussed under *Meal and Entertainment Expenses,* later. You do not, however, have to file an information return to report amounts for which you reimbursed the contractor, as long as he or she adequately accounted to you for these expenses.

No adequate accounting by contractor. If the contractor does not adequately account to you for allowances or reimbursements of meal and entertainment expenses, then you do not have to keep your own separate records of these items incurred by the contractor on your behalf. You are not subject to the limit on meals and entertainment in this case. You can deduct the amounts if they are ordinary and necessary business expenses. However, you must file an information return (Form 1099-MISC) to report amounts paid to the independent contractor if the total of the reimbursements and any other fees is $600 or more during the tax year.

Corporate officer. If you are a corporate officer who has travel, meals, transportation, entertainment, or gift expenses incurred on behalf of the corporation, in order to take a deduction, you must be able to show that they were necessary expenses of the office.

If the expenses were ordinary and necessary expenses of the corporation (as opposed to you as the officer), you cannot deduct them. An expense may be properly allocable to the corporation even if you are reimbursed for the expense by the corporation and even if the board of directors passes a resolution requiring that you incur the expense. Also, if the expenses were primarily for your personal benefit, you cannot deduct them and you must include any reimbursement in your income.

If your job requires that you travel and entertain for the corporation, and you are expected to pay the expenses without reimbursement, you are generally able to deduct them. However, there should be a reasonable relationship between your expenses and your compensation.

Expenses of producing income. Ordinarily you can deduct expenses you incurred to produce or collect income, or to manage, conserve, or maintain property held for producing income, only on Schedule A (Form 1040). Therefore you must itemize your deductions to claim these expenses. See Chapter 30.

However, you can deduct such expenses for property held for producing rents or royalties on Schedule E (Form 1040). See Chapter 10 for information on residential rental property.

Transportation Expenses

Transportation expenses are the ordinary and necessary expenses of getting from one work place to another in the course of your business, profession, or job when you are ***not*** traveling away from home. Expenses for transportation while traveling away from home may be deductible as travel expenses. Travel expenses are discussed later.

Transportation expenses include the cost of travel by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car, but ***not*** the cost of meals and lodging. For information on how to deduct transportation expenses, see *How to Report,* later.

Commuting expenses. You cannot deduct the costs of taking a bus, trolley, subway, taxi, or driving a car between your home and your main or regular place of work. These costs are personal commuting expenses. You cannot deduct commuting expenses no matter how far your home is from your regular place of work. You cannot deduct commuting expenses even if you work during the trip.

Example. You had a telephone installed in your car. You sometimes use that telephone to make business calls while commuting to and from work. Sometimes business associates ride with you to and from work and you have a business discussion in the car. These activities ***do not change*** the trip from commuting to business. Your commuting expenses are not deductible.

Hauling tools or instruments. Hauling tools or instruments in your vehicle while commuting to and from work does not make your commuting costs deductible. However, you can deduct additional costs, such as renting a trailer that is towed by your vehicle, for carrying equipment to and from your job.

Advertising display on car. The use of your car to display material that advertises your business does not change personal use to business use. If you use this car for commuting or other personal use, your expenses for such use are not deductible.

Trips from a union hall. If you get your work assignments at a union hall and then go to your place of work, these costs are nondeductible commuting expenses.

Example. You are a banquet waitress who works at several locations in your hometown

area. Your union requires you to appear at the union hall to receive your work assignment for the day. Although you need the union to get the job, you are employed where you work, not where the union hall is located. Therefore, you cannot deduct the trips from your union hall to your place of work.

Parking fees. Fees paid to park your car at your place of work are nondeductible commuting expenses.

Temporary work location. If you have one or more regular places of business and commute to a temporary work location, you can deduct the expenses of the daily round-trip transportation between your residence and the temporary location. If the temporary work is in the same metropolitan area as your regular place of work, the temporary work must be irregular or short-term (generally a matter of days or weeks). If the temporary work is beyond the general area of your regular place of work, see *Temporary assignment or job* under *Travel Expenses*, later.

Two places of work. If you work at two places in a day, whether or not for the same employer, you can deduct the expense of getting from one place to the other. However, if for some personal reason you do not go directly from one location to the other, you can deduct only the amount it would have cost you to go directly from the first location to the second. Transportation expenses you have in going between home and a part-time job on a day off from your main job are commuting expenses. You cannot deduct them.

Armed forces reservists. A meeting of an armed forces reserve unit is considered a second place of work if the meeting is held on the same day as your regular job. You can deduct the expense of getting from one place to the other, as just discussed. You usually cannot deduct the expense if the meeting is held on a nonwork day for your regular job.

For meetings on nonwork days you can deduct your daily transportation expenses only if the location of the meeting is temporary and you either:

1) Have one or more regular places of work, or
2) Ordinarily work in a particular metropolitan area but not at any specific location and the reserve meeting is held outside that metropolitan area.

You can deduct your expenses for transportation, meals, and lodging if you travel away from home to a Guard or Reserve meeting or camp. Travel away from home generally requires an overnight stay. For more information, see *Travel Expenses*, later.

Car Expenses

If you are required to use a car in your business or work, you may be able to deduct car expenses. The deductible items include the costs of:

Gas	Garage rent	Repairs
Oil	Lease fees	Licenses
Tolls	Rental fees	Insurance
Tires	Parking fees	Depreciation

Instead of figuring actual expenses, you may be able to use the standard mileage rate (discussed later).

Business and personal use. If you use your car for both business and personal purposes, you must divide your expenses between business and personal use.

Example. You are a sales representative for a clothing firm and drive your car 20,000 miles during the year: 12,000 miles for business and 8,000 miles for personal use. You can claim only 60% (12,000 ÷ 20,000) of the cost of operating your car as a business expense.

Car placed in service after June 18, 1984. If you place in service after June 18, 1984, a car that has an unloaded gross vehicle weight of 6,000 pounds or less or, in the case of a truck or van, a gross vehicle weight of 6,000 pounds or less that you use in your work or business other than transporting people or property for pay, your section 179 deduction and depreciation are limited. Also, special rules apply if you use your car 50% or less in your work or business.

Percentage of use. Generally, you must use a car more than 50% for business or work to qualify for the section 179 deduction and recovery (depreciation) deduction. Using your car as an employee is treated as business use only if that use is for the convenience of your employer and required as a condition of your employment.

The use of your car must be required for you to perform your assigned duties properly. Whether this use is required depends on all the facts and circumstances. Your employer does not have to explicitly require that you use your car. However, a mere statement by your employer that the use of your car is required as a condition of employment is not sufficient.

Limits. The total amount of recovery (depreciation) and section 179 deductions you can claim is limited based on the date you placed your car in service. The maximum limits table in this chapter (for cars placed in service after June 18, 1984) shows the limits for the various periods.

If you are self-employed you must use Form 4562, *Depreciation and Amortization*, to figure your depreciation. Use Form 2106 if you are an employee.

For more discussion of the limits that apply to a car, see Publication 917, *Business Use of a Car*. Publication 917 contains a discussion of section 179 and depreciation deductions for your car.

Depreciation. How you figure your depreciation deduction depends on when you first use your car. The rules for cars you first use before 1987 are different than for cars you first use after 1986.

If you dispose of your car that you first used before 1987, you get no depreciation deduction for that car for the year you dispose of it. You can deduct depreciation for the year you first use your car in business if you bought the car before 1987 and keep it until the end of the year. For cars placed in service after 1986, you get a half-year depreciation deduction in the year placed in service and in the year of disposition.

Cars Placed in Service After June 18, 1984 — Maximum Limits[1]

Placed in Service		Depreciation First Year[2]	Depreciation Later Years
After	Before		
6/18/84	1/1/85	$4,000	$6,000[4]
12/31/84	4/3/85	$4,100	$6,200[4]
4/2/85	1/1/86	$3,200	$4,800[4]
12/31/85	1/1/87[3]	$3,200	$4,800[4]
12/31/86	1/1/89	$2,560	$4,100 2nd yr. 2,450 3rd yr. 1,475[4]
12/31/88	—	$2,660	$4,200 2nd yr. 2,550 3rd yr. 1,475[4]

[1]These amounts must be reduced if the car is used less than 100% for business purposes.

[2]This is the maximum amount of your section 179 deduction and depreciation allowed for the tax year the car is placed in service.

[3]You could have elected to apply the amounts shown on the "After 12/31/86" line to cars placed in service after July 31, 1986. An investment credit of $875 was allowed if the car qualified as transition property. The reduced investment credit did not apply.

[4]This amount is also the limit on deductions taken in years after the recovery period.

Your depreciation deduction is limited by the percentage of business use. This is the *percentage of your total mileage* during your tax year that you drove your car for business. If the percentage of business use changes, your depreciation deduction changes because the basis for figuring depreciation changes.

For more information on depreciation, see Publication 534.

Leasing a car. If you lease a car that you use in your business or work, you can deduct the part of each lease payment that is for the use of the car in your business or work. You cannot deduct any part of a lease payment that is for commuting to your regular job or other personal use of the car. You must spread any advance payments over the entire lease period. You cannot deduct any payments you make to buy a car even if the payments are called lease payments. If you lease a car after June 18, 1984, that you use in your business or work, you may have to include in income for each tax year you lease the car an amount called the "inclusion amount." For more information, see *Inclusion Amount* in Publication 917.

Standard mileage rate. Instead of figuring actual expenses, you can use the standard mileage rate of 26 cents a mile for an unlimited number of business miles. Beginning in 1990, the 15,000 mile annual limit no longer applies. You can use this rate instead of your actual expenses (including depreciation) in figuring the deductible costs of operating a passenger car, including a van, pickup, or panel truck. You can use the standard mileage rate whether or not you are reimbursed and whether or not any reimbursement is more or less than the amount figured using the standard mileage rate.

Rural mail carriers. If you are a U.S. Postal Service employee who collects or delivers mail on a rural route, you can use a special 39 cents a mile standard mileage rate. You can use this special rate for an unlimited number of miles each year. You ***cannot*** use this rate if you claimed any depreciation expense under the actual expense method for 1988 or 1989.

Choosing the standard mileage rate. If you want to use the standard mileage rate for a car in any year, you must choose to use it in the first year you place the car in service in your business. In later years, you can use the standard mileage rate or actual expenses. If you do not choose the standard mileage rate in the first year, you cannot use it for that car in any year.

If you use the standard mileage rate in the first year of business use, you are considered to have made an election not to use the accelerated cost recovery system (ACRS) or the modified accelerated cost recovery system (MACRS). This is because the standard mileage rate allows for depreciation. You also cannot claim the section 179 deduction. If you change to the actual cost method in a later year, but before your car is considered fully depreciated, you have to estimate the useful life of the car and use straight line depreciation.

To use the standard mileage rate you must:

1) Own the car,
2) Not use the car for hire, for example as a taxi, and
3) Not operate a fleet of cars using two or more at the same time.

Interest and state and local taxes. If you itemize your deductions on Schedule A, you can deduct part of the interest on car loans and state and local personal property taxes on motor vehicles even if you use the standard mileage rate. See Chapters 23 and 24 for more information.

Parking fees and tolls. In addition to the standard mileage rate, deduct any parking fees and tolls you have during business use.

Fully depreciated. Depreciation was allowed in the following years at the rates shown below. The depreciation rate was included in the standard mileage rate for those years. These rates do not apply for any year in which the actual cost method was used. This depreciation reduces the basis of your car in figuring its adjusted basis when you dispose of it.

Year	Rate per Mile
1989 – 1990	11 cents
1988	10.5 cents
1987	10 cents
1986	9 cents
1983 – 1985	8 cents
1982	7.5 cents
1980 – 1981	7 cents

Example. In 1986 you bought a car for exclusive use in your business. The car cost $6,000. From 1986 through 1989 you used the standard mileage rate to figure your car expense deduction. You drove your car at least 15,000 business miles each year. Your car is considered fully depreciated by the end of 1989. This is computed as follows.

Cost	6,000
Less Depreciation:	
1986 15,000 × .09	(1,350)
1987 15,000 × .10	(1,500)
1988 15,000 × .105	(1,575)
1989 15,000 × .11	(1,650)
Remaining Basis	-0-

If you change to the actual cost method in 1990, you cannot take a depreciation deduction for that car.

Adequate accounting. If you adequately account to your employer for reimbursements or allowances for the use of your car and your employer does not include the reimbursed amounts in your income, you can deduct only the cost that is more than your reimbursement or allowance. See *How to Report*, discussed later.

Example. You drive your car 14,000 miles in your work. You get $900 worth of gas from your employer, who has a gas pump for the business. The $900 is not included on your Form W-2. You decide to use the standard mileage rate to figure your car expenses for 1990. You can deduct $2,740 figured as follows.

Business miles driven	14,000
Standard mileage rate	× .26
Total expense	$3,640
Less employer-paid expense	900
Deductible Expense	$2,740

See *How to Report*, later.

Car expense records. Whether or not you use the standard mileage rate, you must keep records to show when you started using your car for business and the cost or other basis of the car. Your records must also show the business miles you drove your car during the year and the total miles you drove your car during the year. If you use actual expenses, you must keep records of the costs of operating the car, such as car insurance, interest, taxes, licenses, maintenance, repairs, depreciation, gas, and oil. If you lease a car, you must also keep records of this cost.

Taxes, interest, and casualty or theft losses. If you use your car as an employee for business purposes, you can claim a deduction for certain expenses. These expenses, which are claimed on Schedule A of Form 1040, are:

Personal property tax on autos (line 7)—See Chapter 23.

A portion of interest (10% of 1990 personal interest paid) on car loans (line 12)—See Chapter 24.

Casualty and theft losses (line 18)—See Chapter 26.

Car pools. You cannot deduct the cost of using your car in a nonprofit car pool. Do not include payments from the passengers in your income. These payments are considered reimbursements of your expenses. However, if you are in a car pool for a profit, you must include these payments in income and you can deduct your expenses (using the rules in this chapter).

Fines and collateral. Fines and collateral for traffic violations are not deductible.

Fringe benefits. Generally, the value of many fringe benefits provided by your employer are taxable and must be included in your income as compensation. If your employer provided you with the use or availability of a vehicle, you received a fringe benefit. For more information see Publication 917.

Travel Expenses

Travel expenses are your ordinary and necessary expenses while traveling away from home for your business, profession, or job. You cannot deduct expenses that are for personal or vacation purposes or to the extent that they are lavish or extravagant.

Deductible travel expenses include:

1) Air, rail, and bus transportation,
2) Operating and maintaining your car,
3) Taxi fares or other costs of transportation between the airport or station and your hotel, from one customer to another, or from one place of business to another,
4) Transportation from the place where you eat and sleep to your temporary work assignment,
5) Baggage charges and transportation costs for sample and display material,
6) Meals and lodging (see *Meal and Entertainment Expenses*, later, for rules on deducting meal expenses),
7) Cleaning and laundry expenses,
8) Telephone and telegraph expenses,
9) Public stenographers' fees,
10) Operating and maintaining housetrailers,
11) Tips that are incidental to any of these expenses, and
12) Other similar ordinary and necessary expenses related to travel.

Travel expenses do not include expenses for entertainment. Travel expenses do not include expenses for transportation while not traveling away from home. These are discussed elsewhere in this chapter.

Away from home. You are traveling away from home if your duties require you to be away from the general area of your tax home (see *Tax Home*, later) substantially longer than an ordinary day's work and, during your time off while away, you need to get sleep or rest to meet the demands of your work. This does not mean napping in your car. You do not have to be away from your tax home for a whole day or from dusk to dawn as long as your relief from duty is long enough to get necessary sleep or rest.

Example 1. You are a railroad conductor. You leave your home terminal on a regularly scheduled round-trip run between two cities and return home 16 hours later. During the run you have 6 hours off at your turnaround point where you eat two meals and rent a hotel room to get necessary sleep before starting the return trip. You are considered to be away from home.

Example 2. You are a truck driver. You leave your terminal and return later the same day. You get an hour off at your turnaround point to eat. Because you are not off to get necessary sleep and the brief time off is not an adequate rest period, you are not away from home.

Standard meal allowance. You can deduct a standard amount for your daily meals (instead of deducting the actual cost) while you are traveling away from home for business. The standard amount is considered adequately accounted for but you must keep records to prove the time, place, and business purpose of your travel. See *Records*, later. Also, see *How to Report*, later for more information and other rules which may apply if your meal expenses are reimbursed by your employer.

Employees and self-employed persons can use the standard meal allowance. You can use the standard meal allowance even if your employer does not reimburse your expenses. However, your unreimbursed meal expenses are subject to the 80% limit discussed later under *Meal and Entertainment Expenses*. You cannot use the standard meal allowance if you are related to your employer (defined later).

The standard meal allowance is $26 per day for most areas. For certain high-cost areas, the allowance is $34 per day. Check the chart *Locations Eligible for $34 a Day Standard Meal Allowance*, below, to see which areas qualify for the higher allowance. If you work in the transportation industry, you may be able to use a special rate. See *Special rate for transportation workers*, later.

The $26 and $34 standard meal allowance rates do not apply to travel in Alaska, Hawaii, or any other locations outside the continental United States. The standard meal allowance for these areas is 40% of the total federal per diem (which includes lodging). See *Regular per diem rate*, later.

Example. You regularly live and work in Chicago. You sometimes travel overnight to Omaha for business. Your employer expects you to pay your expenses out of your regular salary and does not separately or specifically reimburse your expenses for business trips. You must keep receipts to prove the amount of your lodging expense. You can claim the standard meal allowance amount for Omaha, $26, on your Form 2106. You are subject to the 80% limit on meal and entertainment expenses. The balance is subject to the 2% of adjusted gross income limit which applies to most other miscellaneous itemized deductions.

Special rate for transportation workers. You may be able to use a special standard meal allowance if you work in the transportation industry. You are in the transportation industry if your work:

1) Directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and
2) Regularly requires you to travel away from home and, usually part of each trip is in an area eligible for the regular $26 allowance and part of each trip is in an area eligible for the $34 allowance.

If this applies to you, you can claim a $30 a day standard meal allowance ($34 for travel outside the continental United States). If you choose to use this rate for any trip, you cannot use the regular standard meal allowance for any of your trips that year.

Prorating the standard meal allowance. If you are not traveling for the entire 24–hour day, you may prorate the standard meal allowance by dividing the day into 6–hour quarters. The 6–hour quarters are: midnight to 6 a.m.; 6 a.m. to noon; noon to 6 p.m.; and 6 p.m. to midnight. You can claim one-fourth of the full day standard meal allowance for each 6–hour quarter of the day during any part of which you are either traveling or away from home.

Example. You live and work in Los Angeles. Your employer sends you to San Francisco on a temporary assignment. You leave home at 8 a.m. on March 20. Your assignment is completed on March 23. You arrive home at 4 p.m. of that day. You are considered to be traveling for 3½ days (a ¾ day on March 20 + 2 full days + another ¾ day on March 23). Your standard meal allowance is $119 (3½ × $34) while on this assignment.

Related to employer. If you are related to your employer you must be prepared to prove your actual expenses to the IRS even if you used the standard meal allowance to account to your employer. "Related to your employer" means you are related as described in *A loss on the sale or trade* under *Related Party Transactions*, in Chapter 16 except that for this rule you are related if you own directly or indirectly more than 10% of the stock of your employer corporation.

Travel for other purposes. You cannot use the standard meal allowance to prove the amount of your meals if you are traveling for medical, charitable, or moving purposes. You can use it if you are traveling for investment reasons (but see *Investment-related travel*, below) or in connection with obtaining education the expenses of which are deductible.

Educational travel. Expenses for travel that in itself is a form of education are not deductible, even if the travel is directly related to your trade or business. An example would be a teacher of French who travels to France to

Locations Eligible for $34 a Day Standard Meal Allowance

City	County[1]
California	
Death Valley	Inyo
Los Angeles	Los Angeles, Kern, Orange, Ventura; Edwards AFB, China Lake Naval Center
Oakland	Alameda, Marin, Contra Costa
Palm Springs	Riverside
Sacramento	Sacramento
San Diego	San Diego
San Francisco	San Francisco
San Jose	Santa Clara
San Luis Obispo	San Luis Obispo
San Mateo	San Mateo
Santa Barbara	Santa Barbara
Santa Cruz	Santa Cruz
South Lake Tahoe	El Dorado
Tahoe City	Placer
Yosemite National Park	Mariposa
Colorado	
Aspen	Pitkin
Boulder	Boulder
Denver	Denver, Adams, Arapahoe, Jefferson
Keystone/ Silverthorne	Summit
Vail	Eagle
Connecticut	
Hartford	Hartford, Middlesex
Salisbury	Litchfield
District of Columbia	
Washington, DC	Virginia counties of Arlington, Loudoun, and Fairfax and cities Alexandria, Falls Church, and Fairfax. Maryland counties of Montgomery and Prince George's
Florida	
Key West	Monroe
Miami	Dade
West Palm Beach	Palm Beach
Georgia	
Atlanta	Clayton, De Kalb, Cobb, Fulton
Illinois	
Chicago	Cook, Lake, Du Page
Louisiana	
New Orleans	Jefferson, St. Bernard, Orleans, Plaquemines
Maryland (see also Washington, DC)	
Annapolis	Anne Arundel
Baltimore	Baltimore, Harford
Columbia	Howard
Ocean City	Worcester
Massachusetts	
Andover	Essex
Boston	Suffolk
Lowell	Middlesex
Martha's Vineyard/ Nantucket	Nantucket, Dukes
Quincy	Norfolk
Michigan	
Detroit	Wayne
Nevada	
Las Vegas	Clarke; Nellis AFB
New Jersey	
Atlantic City	Atlantic
Eatontown	Monmouth; Fort Monmouth
Edison	Middlesex
Newark	Bergen, Essex, Hudson, Passaic, Union
Ocean City/Cape May	Cape May
Princeton/Trenton	Mercer
New Mexico	
Cloudcroft	Otero
Santa Fe	Santa Fe
New York	
Monticello	Sullivan
New York City	Bronx, Brooklyn, Manhattan, Staten Island, Queens; Nassau, Suffolk
Saratoga Springs	Saratoga
White Plains	Westchester
Ohio	
Cleveland	Cuyahoga
Pennsylvania	
Chester	Delaware
King of Prussia/ Fort Washington	Montgomery
Philadelphia	Philadelphia
Valley Forge	Chester
Rhode Island	
Newport	Newport
South Carolina	
Hilton Head	Beaufort
Texas	
Dallas/Fort Worth	Dallas, Tarrant
Houston	Harris; LBJ Space Center, Ellington AFB
Virginia (see also Washington, DC)	
Williamsburg	
Washington	
Seattle	King

[1]Includes parishes, boroughs, military installations, etc.

maintain general familiarity with the French language and culture. For more information, see Chapter 29, *Employees' Educational Expenses.*

Investment-related travel. If you took a trip to attend a convention, seminar, or similar meeting, and the expenses were not ordinary and necessary expenses of carrying on your trade or business, you cannot deduct any portion of the cost of the trip. For example, you cannot deduct the cost of investment seminars or stockholders' meetings.

New job. You can deduct amounts you spend for travel expenses, including meals (subject to the limit) and lodging, in looking for a new job in your present trade or business. You cannot deduct these expenses if you are looking for work in a new trade or business or in looking for work for the first time. If you are unemployed, and there is a substantial break between the time of your past work and your looking for new work, you cannot deduct these expenses, even if the new work is in the same trade or business as your last previous work. If you are reimbursed or if you received an allowance, see *Interview expenses* in Chapter 6. When you move your home, you may qualify for a moving expense deduction. See Chapter 27.

Tax Home

Generally, your tax home is your main place of business or post of duty, regardless of where you maintain your family home.

Example. You live with your family in Chicago, but work in Milwaukee, where you stay in a hotel and eat in restaurants during the week. You return to Chicago every weekend. You cannot deduct any of your expenses for travel, meals, and lodging in Milwaukee, because that is your tax home and the travel on weekends is not for a business reason.

Entire area. The entire city or general area in which your business or work is located is your tax home.

Two places of business or work. If you regularly work in two or more areas, your tax home is the general area where your main place of business or work is located.

Main place of business or work. You should use the following factors in determining your main place of business or work:

1) The total time you ordinarily spend working in each area,
2) The degree of your business activity in each area, and
3) The relative amount of your income from each area.

Example. You live in Cincinnati where you have a seasonal job for 8 months and earn $15,000. You work the remaining 4 months in Miami, also at a seasonal job, and earn $4,000. Cincinnati is your main place of work because you spend most of your time there and earn most of your income there.

Living away from your tax home. You may be considered as traveling away from home while working in the same city in which you and your family live.

Example. Your family home is in Pittsburgh, where you work 12 weeks a year. The rest of the time you work for the same employer in Baltimore. In Baltimore you eat in restaurants and sleep in a rooming house. Your salary is the same whether you are in Pittsburgh or Baltimore. Because you spend most of your working time and earn most of your salary in Baltimore, that city is your tax home. You cannot deduct any expenses you have for meals and lodging there. However, when you return to work in Pittsburgh you are away from your tax home even though you stay at your family home. Therefore, you can deduct the cost of your round trip between Baltimore and Pittsburgh, and your part of your family living expenses for meals (subject to the limit) and lodging while you are living and working in Pittsburgh.

Temporary assignment or job. Although you regularly work or carry on your business activities within the city or general area of your home, you may have to work or conduct business at another location. It may not be practical to return home from this other location at the end of each day's work.

If your assignment or job away from your regular place of work is temporary, that is, if its end can be foreseen within a fixed and reasonably short time (usually less than one year), your tax home does not change. You are considered to be away from home for the whole period and your travel expenses are deductible. If you expect employment to last for less than one year, whether your new work assignment is temporary or indefinite depends on all the facts and circumstances.

An assignment or job expected to last for a year or more is considered ***indefinite*** and presumed not to be temporary. If an assignment or job is indefinite, you ***are not*** considered to be away from home and your travel expenses are not deductible. Under certain circumstances, you may overcome this one-year presumption if an assignment or job is expected to, and does, last for one year or longer, but less than 2 years. For more information, see Publication 463, *Travel, Entertainment, and Gift Expenses.*

You can deduct the necessary travel expenses of first getting to your temporary assignment or job and then returning to your tax home after the assignment or job ends. Also, you can deduct your reasonable expenses for meals (subject to the limit) and lodging, even for days off, while you are at the temporary location.

Returning home. If you go home on your days off, you are not away from home while you are in your hometown. You cannot deduct the cost of your meals and lodging there. However, you can deduct your travel expenses, including meals (subject to the limit) and lodging, while traveling from the area of your temporary place of work to your hometown and back to work. You can claim these expenses up to the amount it would have cost you for meals and lodging had you stayed at your temporary place of work. If you keep your hotel room during your visit home, you can deduct your expenses of returning home only up to the amount you would have spent for meals had you stayed at your temporary place of work.

Indefinite assignment. If your job at the new location is for an indefinite time, that is, if its end cannot be foreseen within a fixed and reasonably short time, that location becomes your new tax home. You cannot deduct your travel, meals, and lodging expenses while there. You must include any amounts you receive from your employer for living expenses in your income, even if they are called travel allowances and you account to your employer for them.

You must determine whether your assignment is temporary or indefinite when you start work. A series of assignments to the same location, all for short periods but which together cover a long period, may be considered an indefinite assignment.

Probationary work period. If you take a job that requires you to move, with the understanding that you will keep the job if your work is satisfactory during a test period, the job is indefinite. You cannot deduct any expenses for meals and lodging for the test period.

Transient workers. If you move from job to job, maintain no fixed home, and are associated with no particular business locality, each place you work becomes your main place of business and your tax home. You cannot deduct your expenses for meals and lodging.

Travel in the United States

If your trip was entirely for business, you can deduct your ordinary and necessary travel expenses. If your trip was primarily personal, you cannot deduct any travel expenses, even if you had some business activity at your destination.

Primarily business. If your trip was primarily for business and, while at your business destination, you extended your stay for vacation, made a nonbusiness side trip, or had other nonbusiness activities, you can deduct the travel expenses to and from your business destination.

Example. You work in Atlanta and make a business trip to New Orleans. On your way home, you stop in Mobile to visit your parents. You spend $450 for the 9 days you are away from home for travel, meals, lodging, and other travel expenses. If you had not stopped in Mobile, you would have been gone only 6 days and your total cost would have been $400. You can deduct $400 (subject to the limit on meals) for your trip, including the round-trip transportation to and from New Orleans.

Primarily vacation. If your trip was primarily for vacation, the entire cost of the trip is a nondeductible personal expense, except for any expenses you have while at your destination that are directly allocable to your business.

A trip may be a vacation even if the promoter advertises that a trip to a resort or on a cruise ship is primarily for business. The scheduling of incidental business activities during a trip, such as viewing video tapes or attending lectures dealing with general subjects, will not change what is really a vacation into a business trip.

Partially outside the U.S. If part of the trip is outside the United States, the expenses for that part of the trip are deductible under the rules discussed in *Travel Outside the United States,* later. The expenses for the part of the trip in the United States are deductible under the rules discussed in this section. The United States includes the 50 states and the District of Columbia. Travel outside the United States does not include travel from one point in the United States to another point in the United States.

Public transportation. If you travel by public transportation, any place in the United States where that vehicle makes a scheduled stop is a point in the United States.

Private car. Travel by private car in the United States is travel between points in the United States, even though you are on your way to a destination outside the United States.

Private plane. If you travel by private plane, any trip, or part of a trip, for which both your takeoff and landing are in the United States is travel in the United States, even if part of your flight is over a foreign country.

Convention expenses. You can deduct travel expenses for yourself, but not for your family, to attend a convention if you can show that your attendance benefits your trade or business. If the convention is for investment, political, social, or other purposes unrelated to your trade or business, you cannot deduct the expenses. Nonbusiness expenses, such as social or sightseeing expenses, are personal

expenses and are not deductible. Your appointment or election as a delegate does not, in itself, entitle you to, or deprive you of, a deduction. See *Foreign conventions*, later.

Convention agenda. The agenda of the convention need not deal specifically with your official duties or the responsibilities of your position or business. It is enough if the agenda is so related to your active trade or business and your responsibilities that attendance for a business purpose is indicated.

Expenses paid by others. You cannot deduct expenses paid by others or personal expenses you paid for your family members. You must reduce the expenses you pay by reimbursements or allowances received from others.

Expenses for your spouse. If your spouse goes with you on a business trip or to a business convention, you cannot deduct the part of the expenses for travel, meals, and lodging for your spouse, unless you can prove a real business purpose for your spouse's presence. Incidental services, such as typing notes or assisting in entertaining customers, are not enough to warrant a deduction.

Example. You drive to Chicago on business and take your spouse with you. No business purpose is served by your spouse's presence. You pay $115 a day for a double room. A single room costs $90 a day. You can deduct the total cost of driving your car to and from Chicago, but only $90 a day for your hotel room. If you use public transportation, you can only deduct your fare.

Travel Outside the United States

If you travel outside the United States and the entire time is spent on business activities, you can deduct your travel expenses as if the travel had been entirely in the United States. Travel outside the United States does not include travel from one point in the United States to another point in the United States. If part of your trip is in the United States, the expenses for that part of the trip are deductible under the rules discussed in *Travel In the United States*, earlier. The expenses for the part of the trip outside the United States are deductible under the rules discussed in this section.

Primarily business. If your travel was primarily for business, but there were some nonbusiness activities, you may not be able to deduct all of your travel costs, including meals and lodging, while going from your home to your business destination and back. You may have to divide the expenses between business and nonbusiness activities.

Primarily vacation. If your travel was primarily for vacation, or for investment purposes, and some time was spent attending brief professional seminars or a continuing education program, the entire cost of the trip is a nondeductible personal expense, except for registration fees and any other expenses incurred that were directly related to your business.

Example. You are a doctor practicing medicine and are a member of a professional association. The association sponsored a 2-week trip to two foreign countries with three professional seminars in each country. Each seminar was 2 hours long and was held in a different city. You also made an optional side trip to a well-known tourist attraction in each of the countries visited. At the end of the trip you received a Certificate of Continuing Education in Medicine.

You paid the cost of air fare, hotel accommodations, meals, a special escort, transportation to and from hotels, and tips. No part of the cost was for the seminars, which were arranged for you by the sponsoring professional association.

Your participation in the professional seminars did not change what was essentially a vacation into a business trip. Your travel expenses were not related primarily to your business. You had no other expenses that were directly for your business. Therefore, you cannot deduct the cost of your trip as an ordinary and necessary business expense.

Travel considered entirely for business. You can deduct your expenses for travel outside the United States using the same rules that apply to travel in the United States, if you meet any one of the following conditions.

1) You were an employee, were not related to your employer, were not a managing executive, and were reimbursed or received a travel expense allowance.

   "Related to your employer" was defined earlier. A managing executive is an employee who, because of executive authority and responsibility is authorized, not subject to the veto of another, to decide on the need for the business travel.

2) You did not have substantial control over arranging the trip. You are not considered to have substantial control merely because you have control over the timing of your trip.

   A self-employed person is generally regarded as having substantial control over arranging business trips.

3) You were outside the United States a week or less, combining business and nonbusiness activities. In counting the days, do not count the day you leave the United States, but count the day you return to the United States.

4) You spent less than 25% of the total time you were outside the United States in nonbusiness activities, even if the trip outside the United States was for more than a week. For this purpose, count both the day your trip began and the day it ended.

5) You can establish that a personal vacation was not a major consideration, even if you own your business, are related to your employer, are a managing executive, or have substantial control over arranging the trip.

For a more detailed explanation of the rules relating to travel outside the United States, including luxury water travel, see Publication 463.

Foreign conventions. You cannot deduct expenses for attending a convention, seminar, or similar meeting held outside the North American area ***unless*** the meeting is directly related to your trade or business. Also, it must be as reasonable to hold the meeting outside the North American area as in it.

The North American area includes the United States, its possessions, Canada, Mexico, Jamaica, Barbados, Bermuda, Trinidad and Tobago, Dominica, the Dominican Republic, Micronesia, Grenada, and Palau. For foreign conventions, U.S. possessions include Puerto Rico, Guam, American Samoa, and the U.S. Virgin Islands. For more information, see Publication 463.

Members of the armed forces. Members of the armed forces of the United States on permanent duty assignments overseas are not traveling away from home and cannot deduct their expenses for meals and lodging, even if they are required to maintain a home in the United States for their families who are not allowed to accompany them. If you are transferred from one permanent duty station to another, see Chapter 27.

A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a home for travel expense purposes aboard ship.

Meal and Entertainment Expenses

You may be able to deduct meal and entertainment expenses you have for your trade or business. You can take a deduction if your expenses are directly related to or associated with your trade or business or if certain exceptions apply. You must meet requirements for proving the amount spent and the business nature of the expense.

Entertainment. Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. This includes entertaining guests at night clubs; social, athletic, and sporting clubs; theaters; sporting events; on yachts; or on hunting, fishing, vacation, and similar trips. If you buy a ticket to an entertainment event for a client, you generally cannot take into account more than the face value of the ticket.

Reciprocal entertaining. Expenses are ***not*** deductible when a group of business acquaintances take turns picking up each other's meal or entertainment checks without regard to whether any business purposes are served.

80% Limitation

In general, you can deduct only 80% of your business-related meal and entertainment expenses. This limitation applies to employees or their employers, and to self-employed persons (independent contractors) or their clients, depending on whether the expenses are reimbursed.

The 80% limit applies to meals or entertainment expenses incurred while:

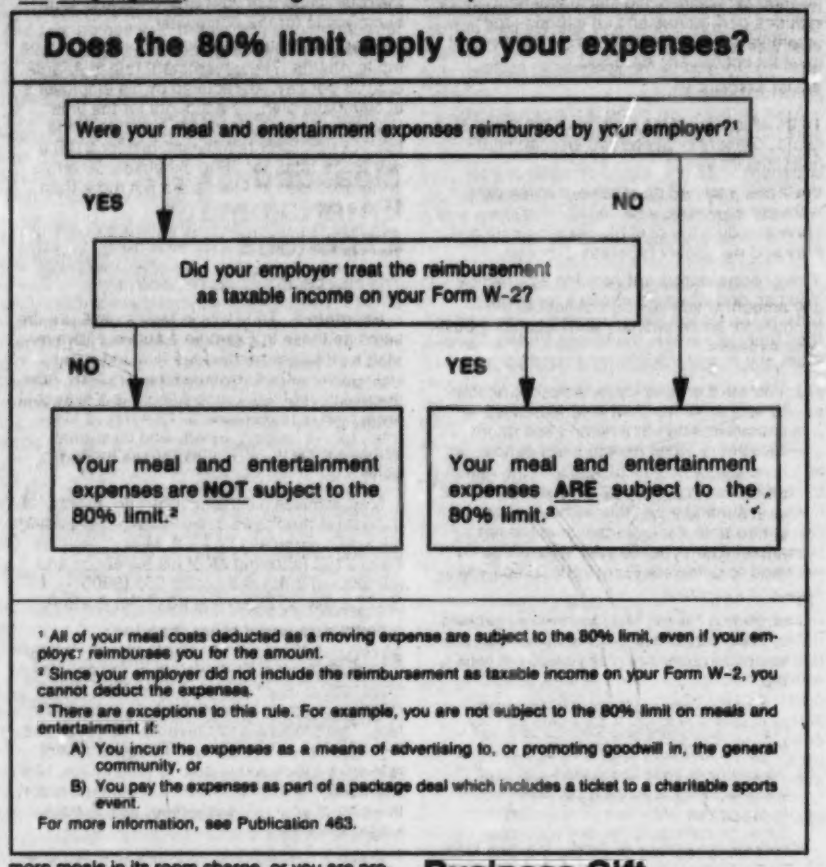
1) Traveling away from home (whether eating alone or with others) on business,
2) Entertaining business customers at your place of business, a restaurant, or other location, or
3) Attending a business convention or reception, business meeting, or business luncheon at a club.

The limit may apply to meals you furnish on your premises to your employees, even if the value of the meals is excluded from the employee's income. There are exceptions, discussed in Publication 463, to the 80% limit.

Taxes and tips relating to a meal or entertainment activity are included in the amount that is subject to the 80% limit. Expenses such as cover charges for admission to a night club, rent paid for a room in which you hold a dinner or cocktail party, or the amount paid for parking at a sports arena, are subject to the 80% limit. However, the cost of transportation to and from a business meal or entertainment activity that is otherwise allowable is not subject to the 80% limit.

If you pay or incur an expense for goods and services consisting of meals, entertainment, and other services (such as lodging or transportation), you must make an allocation, on a reasonable basis, between the expenses for meals and entertainment and the expenses for the other services. For example, you must make an allocation if a hotel includes one or

All employees, including outside salespersons, can use this chart.


Does the 80% limit apply to your expenses?
Were your meal and entertainment expenses reimbursed by your employer?[1]
YES
NO
Did your employer treat the reimbursement as taxable income on your Form W-2?
NO
YES
Your meal and entertainment expenses are NOT subject to the 80% limit.[2]
Your meal and entertainment expenses ARE subject to the 80% limit.[3]
[1] All of your meal costs deducted as a moving expense are subject to the 80% limit, even if your employer reimburses you for the amount.
[2] Since your employer did not include the reimbursement as taxable income on your Form W-2, you cannot deduct the expenses.
[3] There are exceptions to this rule. For example, you are not subject to the 80% limit on meals and entertainment if:
A) You incur the expenses as a means of advertising to, or promoting goodwill in, the general community, or
B) You pay the expenses as part of a package deal which includes a ticket to a charitable sports event.
For more information, see Publication 463.

more meals in its room charge, or you are provided with one per diem amount to cover both your lodging and meal expenses.

Application of 80% limit. The 80% limit on meal and entertainment expense applies if the expense is otherwise deductible and is not covered by one of the exceptions discussed in Publication 463. The limit does not apply only to trade or business expenses. It applies to expenses incurred for the production of income including rental and royalty income. It also applies to deductible moving and educational expenses.

You apply the 80% limit after determining the amount that would otherwise qualify for a deduction. You first have to determine the amount of meal and entertainment expenses that would be deductible under the rules discussed earlier (and in Publication 463). You then apply the 80% limit. Finally, to determine the actual deductible amount, employees must apply the 2% of adjusted gross income limitation on Schedule A.

Example 1. You spend $100 for a business-related meal. If $40 of that amount is not allowable because it is considered lavish and extravagant, the remaining $60 is subject to the 80% limit. Your deduction cannot be more than $48 (80% of $60).

Example 2. You purchase two tickets to a concert and give them to a client. You purchased the tickets through a ticket agent. You paid $150 for the two tickets, which had a face value of $80 each. Your deduction cannot be more than $96 (80% of the face value of the tickets).

Business Gift Expenses

You can deduct the cost of business gifts. However, you cannot deduct more than $25 for business gifts you give, directly or indirectly, to any one individual during your tax year. If a gift to a company is not intended for the eventual personal use or benefit of a particular person or a limited class of people, it will not be considered an indirect gift to an individual.

A gift to the spouse of a person with whom you are doing business is an indirect gift to that person. However, if the spouse you give the gift to has an independent bona fide business connection with you, the gift generally will not be considered an indirect gift to the other spouse, unless it is intended for that spouse's eventual use or benefit. These rules also apply to gifts to any other family member.

If you and your spouse both give gifts, both of you are treated as one taxpayer, even if you have separate businesses or are separately employed and even if each of you has an independent connection with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Exceptions. The following items are not considered gifts subject to the $25 limit.

1) An item that costs $4 or less, on which your name is clearly and permanently imprinted, and which is one of a number of identical items you widely distribute. This includes items such as pens, desk sets, and plastic bags and cases.
2) Signs, display racks, or other promotional material to be used on the business premises of the recipient.

Employee achievement awards. Employee achievement awards are not treated as gifts. For information on how to deduct the cost of these awards, see Publication 535, *Business Expenses.*

Incidental costs. Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are generally not included in determining the cost of a gift for purposes of the $25 rule.

A related cost is considered incidental only if it does not add substantial value to the gift. For example, the cost of gift wrapping is considered an incidental cost, but the purchase of an ornamental basket for packaging fruit is not considered an incidental cost of packaging if the basket has a value that is substantial in relation to the value of the fruit.

Gift or entertainment. Any item that might be considered either a gift or entertainment generally will be considered entertainment. However, if you give a customer packaged food or beverages intended to be used at a later date, it is a gift.

If you provide tickets to a theater performance or sporting event for a business customer and do not go with the customer to the performance or event, you can treat the tickets as either a gift or entertainment, whichever is to your advantage. You can change your treatment of the tickets at a later date, but not after the time prescribed for the assessment of income tax. In most instances this is 3 years after the due date of your income tax return. If you go with the customer to the event, you have no choice; the cost of the tickets is entertainment.

How to Report

How you report expenses for travel, transportation, entertainment, gifts, and other business expenses depends on whether you are self-employed or an employee; the type of expense (travel, entertainment, car, etc.); whether you are a qualified performing artist or handicapped employee; the type of reimbursement or allowance arrangement involved (accountable or nonaccountable); and whether your reimbursement was more than, equal to, or less than your expenses.

Self-employed individuals. Self-employed persons must report their travel, transportation, entertainment, and gift expenses on the appropriate form used to report their business income and expenses (such as Schedule C, Form 1040). For more information, see Publication 334, *Tax Guide for Small Business.*

Employees. If you are an employee, you must complete Form 2106 to deduct your expenses for travel, transportation, meals, or entertainment. If you are not deducting any of these expenses (for example, if your only expenses are for office in the home, gifts, and educational expenses not involving transportation), enter your expenses directly on line 20 of Schedule A.

Statutory employees. Statutory employees report their expenses on Schedule C instead of Form 2106. The statutory employee box on line 6 of your Form W-2 will be checked if you are a statutory employee. See Publication 529, *Miscellaneous Deductions,* for more information.

Qualified performing artist. If you are a qualified performing artist, you can deduct your performing-arts related expenses even if you do not itemize your deductions. You must complete Form 2106, but see the special instructions for line 11. You are a qualified performing artist if:

1) You performed services in the performing arts as an employee for at least two employers in the tax year,
2) You had allowable business expenses attributable to the performing arts of more than 10% of your gross income from the performing arts, and
3) You had adjusted gross income of $16,000 or less (without including expenses as a performing artist).

See Publication 529 for more information.

Employees with disabilities. If you are physically or mentally handicapped, your impairment-related work expenses are not subject to the 2% of adjusted gross income limit that applies to most other employee business expenses. You must complete Form 2106, but see the special instructions for line 11.

Impairment-related work expenses are your allowable expenses for attendant care at your workplace and other expenses in connection with your workplace which were incurred to allow you to work. For more information, see Publication 907, *Tax Information for Persons with Handicaps or Disabilities.*

Unclaimed reimbursement. If you are entitled to a reimbursement from your employer but you do not claim it, you cannot claim a deduction for the expenses to which that reimbursement applies.

Personal expenses reimbursed. Reimbursements for personal expenses received from your employer must be included in your income on line 7 of Form 1040. For example, you must include in income amounts received from your employer for meals if you were not traveling away from home. These expenses are personal and you cannot deduct them.

If You Were Not Reimbursed

You are not reimbursed or given an allowance for your expenses if you are paid a salary or commission with the understanding that you will pay your own expenses. In this situation, you have no reimbursement or allowance arrangement, and you deduct your expenses using either Form 2106 and Schedule A (Form 1040), or only Schedule A (Form 1040) if you are not required to file Form 2106. See *Employees*, earlier for information on which forms to use.

Standard meal allowance. Self-employed persons and employees can use the standard meal allowance (discussed earlier) to figure their deduction for meals. These taxpayers must keep records to prove the time, place, and business purpose of the travel as well as records to prove any expenses other than meals (such as lodging).

If You Were Reimbursed

If you received a reimbursement or allowance for your expenses, how you report this reimbursement and your expenses depends on whether the reimbursement was paid to you from an accountable or nonaccountable plan. The discussions here explain the two types of plans, simplified methods of proving the amount of your expenses, and the tax treatment of your reimbursements and expenses.

Reimbursement or allowance arrangements. A reimbursement or allowance arrangement is a system or plan that an employer uses to pay, substantiate, and recover the expenses, advances, reimbursements, and amounts charged to the employer for employee business expenses. It can also be a system used to keep track of amounts you receive from your employer's agent or a third party. Arrangements include per diem and mileage allowances. If a single payment includes both wages and an expense reimbursement, the amount of the reimbursement must be specifically identified.

Accountable Plans

To be an accountable plan, your employer's reimbursement or allowance arrangement must require you to:

1) Adequately account to your employer for your expenses, and
2) Return any excess reimbursement or allowance.

An "excess reimbursement or allowance" is any amount which you do not adequately account for as an ordinary and necessary business expense.

If your employer reimburses you under an accountable plan and you adequately account to your employer for all of your expenses within a reasonable period of time and you return any excess within a reasonable period of time, your employer should not include any of the reimbursements in your income on your Form W–2. If your expenses equal this reimbursement you can ignore both the expenses and the reimbursement when you file your return. You do not need to complete Form 2106, *Employee Business Expenses.*

If you do not return excess reimbursement. If your expenses are reimbursed under an otherwise accountable plan but you do not return, within a reasonable period of time, any reimbursement for which you did not adequately account, only the amount for which you did adequately account is considered as paid under an accountable plan. The remaining expenses are treated as having been reimbursed under a nonaccountable plan (discussed later).

Reasonable period of time. The definition of "reasonable period of time" depends on the facts of your situation. It is reasonable for you to receive an advance within 30 days of when you have an expense and to adequately account for your expenses within 60 days of when they were paid or incurred. Also, it is considered reasonable if you return any excess reimbursement within 120 days of when the expense was paid or incurred.

If you are given a periodic statement (at least quarterly) that asks you to either return or adequately account for outstanding reimbursements and you comply within 120 days of the statement, the IRS will consider the amount adequately accounted for or returned within a reasonable period of time.

Per diem allowances. How you report a per diem allowance that you received under an accountable plan depends on the government rate for the area where you traveled, and whether the reimbursement or your actual expenses were more than that rate. For this purpose the government rate means the regular federal per diem rate, the High–Low method amount (both discussed later), or the standard meal allowance (discussed earlier). The following discussions compare the ways that reimbursements can relate to the government rate.

Reimbursement NOT more than the government rate. Reimbursement will not be included in boxes 10 and 12 of your Form W–2 if the amount is not more than the government rate. You do not need to report the expenses or the reimbursement on your return if your expenses are equal to or less than the reimbursement. However, if your actual expenses are more than the reimbursement, you can complete Form 2106 and deduct your excess expenses on Schedule A (Form 1040). In this case you must be prepared to prove to the IRS the total amount of your expenses and reimbursements for the entire year.

Example 1. Jeremy takes a 2–day business trip to Atlanta. The government rate in Atlanta is $108 per day. As required by his employer's accountable plan, he accounts for the time (dates), place, and business purpose of the trip. His employer reimburses him for $108 a day ($216 total) for living expenses. Jeremy's living expenses in Atlanta are not more than $108 a day.

Jeremy's employer does not include any of the reimbursement on his Form W–2. Jeremy does not complete Form 2106 or deduct the expenses on his return.

Example 2. The facts in Matt's case are the same as those in *Example 1* above. However, Matt's employer reimburses him under the High–Low method (discussed later under *Adequate Accounting*). Since Atlanta is a high cost area, Matt is reimbursed $122 a day ($244 total) for his lodging, meals, and incidental expenses. Matt's actual expenses totaled $300.

Matt itemizes his deductions and decides to deduct his employee business expenses using his actual expenses of $300. Matt completes Form 2106 (showing ***all*** of his expenses and reimbursements) and enters $56 [$300 − ($122 a day × 2)] on line 20 of Schedule A.

Reimbursement more than the government rate. Your employer will include the reimbursement amount up to the government rate in box 17 of your Form W–2 if your reimbursement is more than the government rate. This amount is not taxable. However, the reimbursement in excess of the government rate will be included in box 10 (and in box 12 if applicable) of your Form W–2. You must report this part of your reimbursement as if it were wages income.

If your expenses are not more than the government rate, you do not complete Form 2106 or claim any of your expenses on your return. However, if your actual expenses are more than the government rate, you can complete Form 2106 and deduct your expenses which exceed the government rate on Schedule A (Form 1040). You must report on Form 2106 all your expenses, and your reimbursements up to the government rate, and be prepared to prove these amounts to the IRS.

Example 1. Laura lives and regularly works in Austin. Her employer sends her to Dallas for 2 days for business. Laura's employer pays directly for her lodging and reimburses her $40 a day ($80 total) for meals. Laura's actual meal expenses do not exceed the government rate for Dallas which is $34 per day. Her employer includes the $12 excess over the government rate [($40 × 2) − ($34 × 2)] in boxes 10 and 12 of Laura's Form W–2 as if it were wages. Her employer shows the $68 ($34 a day × 2) in box 17 of her Form W–2. This amount is not included in Laura's income. Laura does not have to complete Form 2106.

Example 2. The facts in Joe's case are the same as those in *Example 1*, earlier. However, Joe can prove that his actual meal expenses were $100. His employer's accountable plan will not pay more than $40 a day for travel in Dallas, so he does not give his employer the records which prove that he actually spent $100. However, he does account for the time, place, and business purpose of the trip. This is Joe's only business trip in 1990. He completes Form 2106 (showing the total for the year of ***all*** his actual expenses and his reimbursements which were not included in his income) and enters $32 ($100 actual expenses − $68 nontaxable reimbursement shown in box 17 of his Form W–2) on line 20 of Schedule A.

Adequate Accounting

You adequately account to your employer by giving your employer documentary evidence and an account book, diary, or similar record in which you entered each expense at or near the time you had it. See *Records*, later for a discussion of the aspects or elements of each expense that you must prove.

You must account for *all* amounts received from your employer during the year as advances, reimbursements, or allowances for travel, entertainment, gifts, or any other expenses. This includes amounts charged to your employer by credit card or otherwise. You must give your employer the same type of records and supporting information that you would be required to give to the IRS if it questioned a deduction on your return. You must pay back the amount of any reimbursement or other expense allowance for which you do not adequately account or that exceeds the amount for which you accounted.

Per diem allowance or reimbursement. You may be able to prove the amount of your expense by using a per diem allowance amount. If your employer reimburses you for your lodging, meal, and incidental expenses at a fixed amount per day of business travel, that amount is called a per diem allowance. A per diem allowance satisfies the adequate accounting requirements for the amount if:

1) Your employer reasonably limits payments of the travel or transportation expenses to those that are ordinary and necessary in the conduct of the trade or business,
2) The allowance is similar in form to and not more than the federal per diem (that is, your reimbursement varies based on how long you were traveling),
3) You are not related to your employer (as defined earlier under *Travel Expenses*), and
4) The time, place, and business purpose of the travel are proved, as explained later under *Records*.

If the Internal Revenue Service finds that an employer's travel allowance practices are not based on reasonably accurate estimates of travel costs, including recognition of cost differences in different areas, the employees will not have accounted to their employer and may each be required to prove their expenses to the IRS.

These rules also apply if you get reimbursed only for your meal expense or get a separate per diem allowance for meals and incidental expenses that is not more than the standard meal allowance, discussed earlier. A per diem allowance is paid separately for meals and incidental expenses if your employer furnishes lodging in kind, pays you a meal allowance plus the actual cost of your lodging, pays the hotel, motel, etc. directly for your lodging, or if your employer does not have a reasonable belief that you incurred lodging expenses, such as when you stay with friends or relatives or sleep in the cab of your truck.

Instead of claiming the actual cost of your meals while you are traveling away from home on business, you may be able to claim either $26 or $34 a day ($30 a day for transportation workers) for meals. See *Standard meal allowance* under *Travel Expenses*, earlier.

Proving your expenses with a per diem allowance. If your employer reimburses your expenses using a per diem allowance, you can generally use the allowance as proof for the amount of your expenses. However, the amount of expense that can be proven this way cannot be more than the regular federal per diem rate or the High–Low method.

Only the amount will be considered proven under the adequate accounting requirements. You must still prove the time, place, and business purpose for each expense. The two methods of figuring a per diem allowance are discussed here.

Regular per diem rate. The regular federal per diem rate is the highest amount which the federal government will pay to its employees for lodging, meal, and incidental expense (or meal and incidental expense only) while they are traveling (away from home) in a particular area. The rates are different for different locations. You must use the rate in effect for the area where you stop for sleep or rest. Your employer should have these rates available.

Your employer can pay you a special meals-only per diem allowance if you are an employee in the transportation industry. See *Special rate for transportation workers* earlier under *Travel Expenses*.

High–Low method. A simplified method of computing the federal per diem rate can be used for travel within the continental United States. This method avoids the need to keep a current list of the rate in effect for each city in the continental United States.

The High–Low method specifies a limited number of locations where the per diem amount is considered to be $122. All other areas are treated as having an $85 per diem amount. The areas eligible for the $122 per diem amount under the High–Low method are shown in the chart *Locations Eligible for $122 Per Diem Amount*, shown below.

Rules for employers. Employers cannot use both the regular per diem amount and the High–Low method to meet the adequate accounting requirements for a particular employee in a particular year. For purposes of the 80% limit on meal and entertainment expenses, the portion of a per diem allowance attributable to meals is $34 if the travel is in any of the high-cost areas shown in either of the charts *Locations Eligible for $34 a Day Standard Meal Allowance*, (shown earlier under *Travel Expenses*) or *Locations Eligible for $122 Per Diem Amount*, shown below. For all other areas, $26 is considered to be paid for meals.

For travel outside the continental United States for which the federal government has not established a specific amount for meal and incidental expense, the amount attributable to meals is 40% of the total applicable federal per diem rate (which includes lodging).

If an employer provides some of an employee's meals in kind, the employer does not have to reduce the reimbursement for meal and incidental expenses, provided the employer reasonably believes that the employee has or will have such expenses.

Partial day per diem reimbursement. The federal per diem rate or the federal meal and incidental expense rate is for a full 24 hour day of travel. If the travel is for a partial day, an employer can use either of the following methods to figure the federal per diem for that day.

1) Count one fourth of the federal meal and incidental rate for each 6–hour quarter of the day during any portion of which the employee is traveling away from home for business. The 6–hour quarters are midnight to 6 a.m.; 6 a.m. to noon; noon to 6 p.m.; and 6 p.m. to midnight.
2) Prorate the federal rate using any method which is consistently applied and in accordance with reasonable business practice. For example, an employer can treat 2 full days of per diem paid for travel away from home from 9 a.m. of one day to 5 p.m. of the next day as being no more than the federal rate even though a federal employee would be limited to a reimbursement for only 1½ days.

Locations Eligible for $122 Per Diem Amount

City	County[1]
California	
Death Valley	Inyo
Los Angeles	Los Angeles, Kern, Orange, Ventura; Edwards AFB, China Lake Naval Center
Palm Springs	Riverside
San Francisco	San Francisco
Santa Barbara	Santa Barbara
Colorado	
Aspen	Pitkin
Vail	Eagle
District of Columbia	
Washington, DC	Virginia counties of Arlington, Loudoun, and Fairfax and cities Alexandria, Falls Church, and Fairfax. Maryland counties of Montgomery and Prince George's
Georgia	
Atlanta	Clayton, De Kalb, Cobb, Fulton
Illinois	
Chicago	Cook, Lake, Du Page
Maryland (see also Washington, DC)	
Annapolis	Anne Arundel
Columbia	Howard
Ocean City	Worcester
Massachusetts	
Andover	Essex
Boston	Middlesex, Norfolk, Suffolk
Martha's Vineyard/ Nantucket	Nantucket, Dukes
Plymouth	Plymouth
New Hampshire	
Conway	Carroll
New Jersey	
Atlantic City	Atlantic
Newark	Bergen, Essex, Hudson, Passaic, Union
Ocean City/Cape May	Cape May
Princeton/Trenton	Mercer
New York	
New York City	Bronx, Brooklyn, Manhattan, Staten Island, Queens; Nassau, Suffolk
White Plains	Westchester
Pennsylvania	
Philadelphia	Philadelphia, city of Bala-Cynwyd
Rhode Island	
Newport	Newport
South Carolina	
Hilton Head	Beaufort
Texas	
Dallas/Fort Worth	Dallas, Tarrant
Virginia	See Washington, DC

[1]Includes parishes, boroughs, military installations, etc.

These rules apply whether your employer uses the regular or the High–Low method of computing your per diem allowance.

Expenses more than per diem amount. If your expenses are more than the amount considered proven because you received a per diem allowance, you can complete Form 2106 and deduct the excess expenses on Schedule A (Form 1040) if you itemize your deductions. You must be prepared to prove to the IRS both the amount of your expenses and your reimbursements for the entire year.

Returning Excess Reimbursements

A reimbursement or other expense allowance arrangement is not considered an accountable plan unless you return any excess reimbursement to the person paying the reimbursement. "Excess reimbursement" means any amount for which you did not adequately account within a reasonable period of time. "Adequate accounting" and "reasonable period of time" were discussed earlier.

Per diem allowances. Your employer's reimbursement arrangement is considered an accountable plan even if you do not return the amount of an unspent per diem allowance to your employer as long as you prove that you did travel that day. This is because the amount (up to the amount computed under the regular per diem rate or High–Low method, discussed earlier) of the allowance is considered proven. Your employer will include as income on your Form W–2 the amount of your per diem allowance that exceeds the amount computed under the regular per diem amount or the High–Low method. This amount is considered paid under a nonaccountable plan.

You must prove that you actually traveled on each day for which you received a per diem allowance. To meet the return of excess reimbursement requirements, you must return the per diem allowance you received for all days that you do not prove were days of business travel.

Travel advance. If your employer provides you with an expense allowance, reasonably calculated not to exceed your expected expenses, before you actually have the expense, you have received a travel advance. You must adequately account to your employer for such an advance and be required to return any excess within a reasonable period of time. See *Reasonable period of time*, earlier. If you do not adequately account or do not return any excess reimbursement within a reasonable period of time, the unaccounted for or unreturned amount will be treated as having been paid under a nonaccountable plan.

Car or mileage allowance. You may be able to prove the amount of your transportation expense by using a car or mileage allowance amount. You have received a car or mileage allowance if your employer reimburses your expenses:

1) At a fixed amount per mile of business travel,

Reporting Travel, Transportation, Meal and Entertainment Expenses and Reimbursements

Type of Reimbursement or Other Expense Allowance Arrangement	**Employer** Reports on Form W-2	**Employee** Shows on Form 2106	**Employee** Claims on Schedule A
Accountable Adequate accounting and excess returned	Not reported	Not shown	Not claimed
Adequate accounting and return of excess both required but excess not returned	Excess reported as wages in Box 10 and, if applicable, in Box 12. Amount adequately accounted for is reported only in Box 17—it is *not* reported in Box 10 or in Box 12.	All expenses, and reimbursements reported on Form W-2, Box 17, *only* if some or all of the unreturned excess expenses are claimed.[1] Otherwise, form is not filed.	Expenses the employee can prove and which exceed the reimbursements received and reported on Form W-2, Box 17.[2]
Per diem or mileage allowance (up to government rate) Adequate accounting and excess returned	Not reported	All expenses and reimbursements *only* if excess expenses are claimed.[1] Otherwise, form is not filed.	Expenses the employee can prove and which exceed the reimbursements received.[2]
Per diem or mileage allowance (exceeds government rate) Adequate accounting up to the government rate only and excess not returned	Excess reported as wages in Box 10 and, if applicable, in Box 12. Amount up to the government rate is reported only in Box 17—it is *not* reported in Box 10 or in Box 12.	All expenses, and reimbursements equal to the government rate, *only* if expenses in excess of the government rate are claimed.[1] Otherwise, form is not filed.	Expenses the employee can prove and which exceed the government rate.[2]
Nonaccountable Either adequate accounting or return of excess, or both, not required	Entire amount is reported as wages in Box 10 and, if applicable, in Box 12.	All expenses[1]	Expenses the employee can prove.[2]
No reimbursement	Normal reporting of wages, etc.	All expenses[1]	Expenses the employee can prove.[2]

[1] Any allowable expense is carried to line 20 of Schedule A and deducted as a miscellaneous itemized deduction.

[2] These amounts are subject to the applicable limits including the 80% limit on meals and entertainment expenses and the 2% of adjusted gross income limit on the total miscellaneous itemized deductions.

2) With a variable amount depending on your miles plus a flat amount based on a standard vehicle and the area, or

3) By any other method that is consistently applied and in accordance with reasonable business practice.

Reporting a car or mileage allowance. How you report a car or mileage allowance that you received under an accountable plan depends on whether the reimbursement or your actual expenses were more than the standard mileage rate and whether your expenses were more than the reimbursement. The standard mileage rate is the same as that discussed under *Standard mileage rate* earlier.

The rules on accounting for and reporting car expenses and a car or mileage allowance are the same as the rules for reporting a per diem reimbursement for travel expenses and the travel expenses you incurred. See the previous discussions. However, you can prove the amount of your expense with a car or mileage allowance even if you are related to your employer. The IRS will generally consider you to have proven the amount of your reimbursement which your employer does *not* include in box 10 of your Form W–2.

Nonaccountable Plans

Any reimbursement or allowance arrangement that does not meet the requirements for an accountable plan (discussed earlier) is a nonaccountable plan. Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other compensation and report the total in box 10 (and box 12 if applicable) of your Form W–2.

You must complete Form 2106 and itemize your deductions on Schedule A (Form 1040) to deduct your expenses for travel, transportation, meals, or entertainment. Your meal and entertainment expenses will be subject to the 80% limit discussed earlier. Also, your total expenses will be subject to the 2% of adjusted gross income limit which applies to most miscellaneous itemized deductions.

Example. Kim's employer gives her $500 a month ($6,000 total) for her business expenses. Her employer does not require Kim to provide any proof of her expenses and Kim can keep any funds which she does not spend.

Kim is being reimbursed under a nonaccountable plan. Her employer will include the $6,000 on Kim's Form W–2 as if it were wages. If Kim wants to deduct her business expenses, she must itemize her deductions and complete Form 2106. The 80% limit applies to her meal and entertainment expenses and the 2% of adjusted gross income limit applies to her total expenses.

Special rule for returning excess reimbursement. If your expenses are reimbursed under an otherwise accountable plan but you do not return, within a reasonable period of time, any reimbursement for which you do not adequately account, only the amount for which you do not adequately account is considered as paid under a nonaccountable plan. The remainder is treated as having been paid under an accountable plan.

Completing Form 2106

The following is a brief description of how to complete Form 2106. The chart *Reporting Travel, Transportation, Meal and Entertainment Expenses and Reimbursements*, shown in this chapter, explains the proper reporting on Form W–2 by the employer and on Form 2106 and Schedule A by the employee. See the *Instructions for Form 2106* for additional information.

Vehicle expenses. If you used a vehicle to perform your job as an employee, you may be able to deduct certain vehicle expenses, as described earlier. Vehicle expenses are generally figured on Part II of Form 2106, and then claimed on line 1, Column A, of Part I of Form 2106.

Employee business expenses other than meals and entertainment. Show your other employee business expenses on lines 2–4, Column A. Do not include expenses for meals and entertainment in these expenses. Line 4 is for expenses such as business gifts, education (tuition and books), office in the home expense, and trade and professional publications. For information on educational expenses that you may be able to deduct, see Chapter 29.

Meal and entertainment expenses. Show the full amount of your expenses for business-related meals and entertainment on line 5, Column B. Include meals while away from your tax home overnight and other business meals. Your meal and entertainment expenses that are subject to the 80% limit are computed in Column B of Form 2106.

Schedule A. After you have completed your Form 2106, follow the directions on that form to deduct your expenses on the appropriate line of your tax return. For most taxpayers this is on line 20 of Schedule A (Form 1040). However, certain performing artists can deduct their expenses on line 30 of Form 1040. Also, handicapped employees may be able to use line 26 of Schedule A (Form 1040).

Limitations. Your meal and entertainment expenses are subject to an 80% limitation. Most miscellaneous itemized deductions, including employee business expenses, are subject to a 2% of adjusted gross income limitation. Apply the 80% limit on your meal and entertainment expenses first (on Form 2106) and then apply the 2% of adjusted gross income limit (on Schedule A).

Allocating your reimbursement. If you were reimbursed under an accountable plan and want to deduct excess expenses which were not reimbursed, you may have to allocate your reimbursement. If your employer paid you a single amount which covers both meals and entertainment, as well as other business expenses, you must allocate the reimbursement so that you will know how much to enter in Column A and Column B of line 7 of Form 2106.

Use the following worksheet to allocate your reimbursement.

1.	Enter the total amount of reimbursements your employer gave you that were not reported to you in Box 10 of Form W–2	_____
2.	Enter the total amount of your expenses for the periods covered by this reimbursement	_____
3.	Of the amount on line 2, enter your total expense for meals and entertainment	_____
4.	Divide line 3 by line 2. Enter the result as a decimal (to at least two places)	_____
5.	Multiply line 1 by line 4. Enter the result here and in Column B, line 7	_____
6.	Subtract line 5 from line 1. Enter this result here and in Column A, line 7	_____

Example. Assume your employer paid you an expense allowance of $5,000 during 1990 under an accountable plan. You actually spent $6,500 during the year ($2,000 for meals and $4,500 for automobile expenses). First, divide your meal expenses by your total expenses ($2,000 ÷ $6,500). The result is .31. Multiply this decimal by your reimbursement (.31 × $5,000). The result is $1,560 (the amount of reimbursement attributable to your meals). Enter this amount on line 7, Column B of Form 2106. Enter the remainder of the reimbursement ($5,000 − $1,550) or $3,450 in Column A of Form 2106.

Records

You must be able to prove your deductions for transportation, travel, meal, entertainment, and business gift expenses by adequate records or by sufficient evidence that will support your own statement. Estimates or approximations do not qualify as proof of an expense.

Proving expenses. You can deduct expenses for transportation, travel, including meals, lodging, and related items while away from home, or expenses for a type of activity generally considered entertainment, amusement, or recreation, or expenses for a facility used in connection with such activity, or expenses for gifts, only if you can prove certain items.

Deductions are not allowed for approximations or estimates, or to the extent that the expense is lavish or extravagant. A receipt is ordinarily the best evidence to prove the amount of an expense.

Chart showing proof required. The chart shown on the next page summarizes the factors in proving the elements of your expenses for travel, transportation, meals, entertainment, and gifts.

To deduct these expenses, you must be able to prove the items listed in Column 1 of the chart. You prove these items by having the information and receipts (where required) for the expenses listed in Column 2, 3, 4, or 5, whichever is applicable.

Adequate records. You should keep the proof you need for these items in an account book, diary, statement of expense, or similar record, supported by adequate documentary evidence (such as receipts, canceled checks, or bills), that together will support each element of an expense. Written evidence has considerably more value than oral evidence alone.

Timely recordkeeping. You do not need to write down the elements of every expense at the time of the expense. However, a record of the elements of an expense or of a business use made at or near the time of the expense or use, supported by sufficient documentary evidence, has more value than a statement prepared later when generally there is a lack of accurate recall. A log maintained on a weekly basis, which accounts for use during the week, is considered a record made at or near the time of the expense or use.

Duplicate information. You do not have to record information in your account book or other record that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner. You do not have to record amounts your employer pays directly for any ticket or other travel item. However, if you charge these items to your employer, through a credit card or otherwise, you must make a record of the amounts you spend.

Expense accounts. An expense account statement you give your employer, client, or customer is considered an adequate record of your expenses. The statement must be a copy of your account book or other record.

Separating expenses. Each separate payment usually is considered a separate expense. If you entertain a customer or client at dinner and then go to the theater, the dinner

expense and the cost of the theater tickets are separate expenses. You must record them separately in your records.

Some items may be totaled. You may total some items in reasonable categories. You may make one daily entry for categories such as taxi fares, telephone calls, gas and oil, and other incidental travel costs. Meals should be in a separate category. You should include tips with the costs of the services you received.

Other items should be totaled. Expenses of a similar nature occurring during the course of a single event are considered a single expense. For example, if during entertainment at a cocktail lounge, you pay separately for each serving of refreshments, the total expense for the refreshments is treated as a single expense.

Documentary evidence. Documentary evidence is required to support all lodging expenses (however, see *Per diem allowance or reimbursement*, earlier) while traveling away from home. It is also required for any other expense of $25 or more, except that if evidence is not readily available for transportation charges, it is not required.

Adequate evidence. Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense. For example, a hotel receipt is enough to support expenses for business travel if it has the name and location of the hotel, the dates you stayed there, and separate amounts for charges such as lodging, meals, and telephone. A restaurant receipt is enough to prove an expense for a business meal if it has the name and location of the restaurant, the number of people served, and the date and amount of the expense. If a charge is made for items other than meals and beverages, the receipt must show that this is the case.

Canceled check. A canceled check, together with a bill from the payee, ordinarily establishes the cost. However, a canceled check does not prove a business expense without other evidence to show that it was for a business purpose.

Business purpose. A written statement of the business purpose of an expense is generally required. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, a written explanation is not required.

Example. A sales representative who calls on customers on an established sales route does not have to submit a written explanation of the business purpose for traveling that route.

Confidential information. Confidential information relating to an element of a deductible expense, such as the place, business purpose, or business relationship, need not be put in your account book, diary, or other record. However, the information has to be recorded elsewhere at or near the time of the expense and be available to fully prove that element of the expense.

Inadequate records. If you do not have adequate records to prove an element of an expense, then you must prove the element by:

1) Your own statement, whether written or oral, containing specific information in detail as to the element, and
2) Other supporting evidence sufficient to establish the element.

Additional information. The IRS may require additional information to clarify or to establish the accuracy or reliability of information contained in your records, statements, testimony, or documentary evidence before a deduction is allowed.

Keeping records and receipts. You must keep proof to support your claim to a deduction as long as your income tax return can be examined. Generally, it will be necessary for you to keep your records for 3 years from the date you file the income tax return on which the deduction is claimed. A return filed early is considered as filed on the due date.

Employees who give their records and documentation to their employers and are reimbursed for their expenses generally do not have to keep duplicate copies of this information. However, you may be required to prove your expenses if:

1) You claim deductions for expenses that are more than reimbursements,
2) Your expenses are reimbursed under a nonaccountable plan,
3) Your employer does not use adequate accounting procedures to verify expense accounts, or
4) You are related to your employer, as discussed earlier.

Filled-in Form 2106. John Jensen is employed as an outside salesperson by Atlas Garment Co., 1145 Morrison Ave., New York, NY 10123. He uses the standard mileage rate to figure his car expense deduction. He records his total mileage, business mileage, parking fees, and tolls for the year. During the year he drove his car a total of 40,000 miles, of which 32,000 miles were for business. He paid $680 for parking fees and tolls while using his car for business.

John paid $10,000 for lodging, and related items (laundry, cleaning, etc.) while on sales trips away from home. John also paid $2,632 for business meals and $5,870 for business entertainment. He received no expense allowance or reimbursement.

John files Form 2106, *Employee Business Expenses*, with his tax return. He deducts all of his employee business expenses on line 20 of Schedule A (Form 1040). His completed form is shown on the next 2 pages.

Elements to be proved (1)	Travel Expenses (2)	Meal and Entertainment Expenses (3)	Gift Expenses (4)	Transportation (car) Expenses (5)
Amount	Amount of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories, such as taxis, daily meals for traveler, etc.	Amount of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Cost of gift.	1) Amount of each separate expense including cost of the car, 2) Mileage for each business use of the car, and 3) Total miles for the tax year.
Time	Date you left and returned for each trip, and number of days for business.	Date of meal or entertainment or use of a facility for entertainment. For meals or entertainment directly before or after a business discussion, the date and duration of the business discussion.	Date of gift.	Date of the expense or use.
Place	Name of city or other designation.	Name and address or designation of place of meal or entertainment, or place of use of a facility for entertainment. Type of entertainment if not otherwise apparent. Place where business discussion was held if meal or entertainment is directly before or after a business discussion.	Not applicable.	Name of city or other designation if applicable.
Description	Not applicable.	Not applicable.	Description of gift.	Not applicable.
Business purpose	Business reason for travel or the business benefit gained or expected to be gained.	Business reason or the business benefit gained or expected to be gained. Nature of business discussion or activity.	Business reason for giving the gift or the business benefit gained or expected to be gained.	Business reason for the expense or use of the car.
Business relationship	Not applicable.	Occupations or other information—such as names or other designations—about persons entertained that shows their business relationship to you. If all people entertained did not take part in business discussion, identify those who did. You must also prove that you or your employee were present at the meal.	Occupation or other information—such as name or other designation—about recipient that shows his or her business relationship to you.	Not applicable.

Form **2106**

Department of the Treasury
Internal Revenue Service

Employee Business Expenses

▶ See separate Instructions.

▶ Attach to Form 1040.

OMB No. 1545-0139

1990

Attachment Sequence No. 54

Your name	Social security number	Occupation in which expenses were incurred
John Jensen	246 00 1357	Salesman

Part I **Employee Business Expenses and Reimbursements**

STEP 1 Enter Your Expenses		Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29	1	8,320	
2 Parking fees, tolls, and local transportation, including train, bus, etc.	2	680	
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. **Do not** include meals and entertainment	3	10,000	
4 Business expenses not included on lines 1 through 3. **Do not** include meals and entertainment	4		
5 Meals and entertainment expenses. (See the separate Instructions.)	5		8,502
6 Add lines 1 through 5 and enter the **total expenses** here	6	19,000	8,502

Note: *If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.*

STEP 2 Enter Amounts Your Employer Gave You For Expenses Listed In STEP 1

7 Enter amounts your employer gave you that were **not** reported to you in Box 10 of Form W-2. Include any amount reported under code "L" in Box 17 of your Form W-2. (See Instructions.)	7		

STEP 3 Figure Expenses To Deduct on Schedule A (Form 1040)

8 Subtract line 7 from line 6	8	19,000	8,502
Note: *If **both columns** of line 8 are zero, **stop here.** If column A is less than zero, report the amount as income and enter -0- on line 10, column A. See the separate Instructions for how to report.*			
9 Enter 20% (.20) of line 8, Column B	9		1,700
10 Subtract line 9 from line 8	10	19,000	6,802
11 Add the amounts on line 10 of both columns and enter the total here. **Also enter the total on Schedule A (Form 1040), line 20.** (Qualified performing artists and individuals with disabilities, see the separate Instructions for special rules on where to enter the total.) ▶	11		25,802

For Paperwork Reduction Act Notice, see the separate Instructions. Form **2106** (1990)

Part II Vehicle Expenses (See Instructions to find out which sections to complete.)

Section A.—General Information

			(a) Vehicle 1	(b) Vehicle 2
12	Enter the date vehicle was placed in service	12	1/2/90	/ /
13	Total mileage vehicle was used during 1990	13	40,000 miles	miles
14	Miles included on line 13 that vehicle was used for business	14	32,000 miles	miles
15	Percent of business use (divide line 14 by line 13)	15	80 %	%
16	Average daily round trip commuting distance	16	10 miles	miles
17	Miles included on line 13 that vehicle was used for commuting	17	2,600 miles	miles
18	Other personal mileage (add lines 14 and 17 and subtract the total from line 13)	18	5,400 miles	miles

19 Do you (or your spouse) have another vehicle available for personal purposes? ☒ Yes ☐ No

20 If your employer provided you with a vehicle, is personal use during off duty hours permitted? ☐ Yes ☐ No ☒ Not applicable

21a Do you have evidence to support your deduction? ☒ Yes ☐ No. 21b If "Yes," is the evidence written? ☒ Yes ☐ No

Section B.—Standard Mileage Rate (Use this section only if you own the vehicle.)

22 Multiply line 14 by 26¢ (.26). Enter the result here and on line 1. (Rural mail carriers, see the separate Instructions.) 22 8,320

Section C.—Actual Expenses

		(a) Vehicle 1	(b) Vehicle 2
23	Gasoline, oil, repairs, vehicle insurance, etc. 23		
24a	Vehicle rentals 24a		
b	Inclusion amount 24b		
c	Subtract line 24b from line 24a 24c		
25	Value of employer-provided vehicle (applies only if 100% annual lease value was included on Form W-2. See Instructions.) 25		
26	Add lines 23, 24c, and 25 26		
27	Multiply line 26 by the percentage on line 15 27		
28	Enter amount from line 38 below 28		
29	Add lines 27 and 28. Enter total here and on line 1 29		

Section D.—Depreciation of Vehicles (Use this section only if you own the vehicle.)

		(a) Vehicle 1	(b) Vehicle 2
30	Enter cost or other basis. (See Instructions.) 30		
31	Enter amount of Section 179 deduction. (See Instructions.) 31		
32	Multiply line 30 by line 15. (See Instructions if you elected the Section 179 deduction.) 32		
33	Enter depreciation method and percentage. (See Instructions.) 33		
34	Multiply line 32 by the percentage on line 33. (See Instructions.) 34		
35	Add lines 31 and 34 35		
36	Enter the limitation amount from the table in the line 36 instructions. 36		
37	Multiply line 36 by the percentage on line 15 37		
38	Enter the smaller of line 35 or line 37. Also enter it on line 28 above 38		

29. Employees' Educational Expenses

This chapter explains what work-related educational expenses qualify for deduction, how to report your expenses, and which forms and schedules to use. If you have questions not answered here, see Publication 508, *Educational Expenses.*

Qualifying Education

Even though the education may lead to a degree, you may deduct expenses if the education:

1) Is required by your employer or the law to keep your salary, status, or job (and serves a business purpose of your employer), or
2) Maintains or improves skills required in your present work.

However, you cannot deduct educational expenses, even though the requirements listed above are met, if the education:

1) Is needed to meet the minimum educational requirements of your present trade or business, or
2) Is part of a program of study that can qualify you for a new trade or business, even if you have no plans to enter that trade or business.

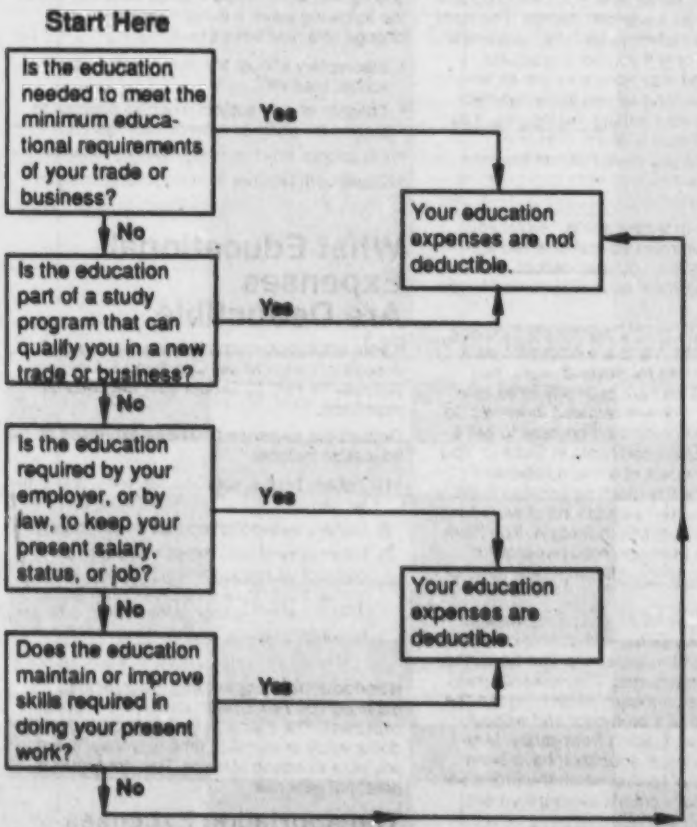
See *Nonqualifying Education,* later.

Present work. You can only deduct educational expenses that relate to your present work. You cannot deduct expenses for education that will relate to work you may enter in the future. Education that prepares you for a future occupation includes any education that keeps you up-to-date for a return to work or that qualifies you to reenter a job you had in the past.

Temporary absence. If you stop work for a year or less and then go back to the same kind of work, your absence is ordinarily considered temporary. If you have educational expenses during a vacation, temporary leave, or other temporary absence from your job, you may deduct your expenses. However, after your temporary absence you must return to the same kind of work and the education must be qualifying education.

Example. You quit your biology research job to become a full-time biology graduate student for one year. If you return to work in biology research after completing the courses, and if your expenses otherwise qualify, you may deduct them. You may even choose to take a similar job with another employer.

Are Your Educational Expenses Deductible?


Start Here
Is the education needed to meet the minimum educational requirements of your trade or business?
Yes
No
Your education expenses are not deductible.
Is the education part of a study program that can qualify you in a new trade or business?
Yes
No
Is the education required by your employer, or by law, to keep your present salary, status, or job?
Yes
No
Your education expenses are deductible.
Does the education maintain or improve skills required in doing your present work?
Yes
No

Education Required by Employer or by Law

Once you have met the minimum educational requirements for your job, your employer or a law may require you to get more education. The purpose for this additional education must be to keep your present salary, status, or job. You may deduct the expenses for this education if it serves a business purpose of your employer and is not part of a program that will qualify you for a new trade or business.

When you take more education than your employer requires, you may deduct your expenses only if the education maintains or improves skills required in your present work. See *Education to Maintain or Improve Skills,* later.

Example. You are a teacher who has satisfied the minimum requirements for teaching. Your employer requires you to take an additional college course each year to keep your teaching job. You take a course and pay for it yourself. You may deduct your expenses even if you eventually receive a master's degree and an increase in salary because of this extra education.

You may not deduct expenses for more than one course per year if your employer requires only one additional course. But if you can show that the expenses are needed to improve or maintain skills of your job, you may deduct the expenses.

Education to Maintain or Improve Skills

You may deduct expenses for education to maintain or improve skills needed in your job. This includes refresher courses, courses on current developments, and academic or vocational courses. However, if the courses you take can qualify you for a new trade or business, you cannot deduct the expenses. See *Education to Qualify for a New Trade or Business,* later.

Example. You repair televisions, radios, and stereo sets for XYZ Store. To keep up with the latest changes, you take special courses in radio and stereo service. Because these courses maintain and improve skills required in your work, you may deduct your expenses for this education.

Nonqualifying Education

If you need education to meet the minimum requirements for a job or to qualify you for a new job, it is nonqualifying education. You cannot deduct the cost of this education even if it maintains or improves work-related skills or if it is required by your employer or the law.

Education to Meet Minimum Requirements

You cannot deduct expenses to meet the minimum educational requirements to qualify for your present job. The minimum education necessary is determined by:

1) Laws and regulations,
2) Standards of your profession or business, and
3) Your employer's requirements.

You have not necessarily met the minimum educational requirements of your trade or business simply because you are already doing the work.

Once you have met the minimum educational requirements that were in effect when you were hired, you do not have to satisfy this rule again. This means that if the minimum requirements change, you may deduct costs of additional education you need to meet the new requirements for your job.

Example 1. You are a full-time engineering student. You work part time as an engineer for a firm that will employ you full time as an engineer after you finish college. Although your college engineering courses improve your skills in your present job, you cannot deduct your expenses because you need the education to meet the minimum job requirements for a full-time engineer.

Example 2. You are an accountant and you have met the minimum educational requirements of your employer. Your employer later changes the minimum educational requirements and requires you to take college courses to keep your job. You may deduct the cost of these additional courses. They are not minimum requirements because you already have satisfied the initial minimum requirements. However, a new accountant coming into the firm would have to satisfy these new minimum requirements and would not be able to deduct those educational expenses.

Example 3. You have your own accounting business. To improve your skills, you take several courses in tax accounting. You have already met the minimum educational requirements to be an accountant. These courses improve skills required in your business and are not part of a program of study that will qualify you for a new trade or business. You may deduct the cost of these courses.

Requirements for teachers. This discussion applies to teachers and others employed by educational organizations. The minimum educational requirement for teachers is usually set by the state or school district. It is based upon a minimum number of college hours or a college degree usually required of a person hired for that position.

If no requirements exist, you will have met the minimum educational requirement when you become a faculty member.

You generally will be considered a faculty member when one of the following occurs.

1) You have tenure.
2) Your years of service count toward obtaining tenure.
3) You have a vote in faculty decisions.
4) Your school makes contributions for you to a retirement plan other than social security or a similar program.

Example 1. Your state law requires beginning secondary school teachers to have a bachelor's degree, including ten professional education courses. In addition, to keep the job, a teacher must complete a fifth year of training within 10 years from the date of hire. However, if qualified teachers cannot be found, a school may hire persons with only 3 years of college work on the condition that they get the bachelor's degree and the required professional education courses within 3 years.

Under these facts, the bachelor's degree, whether it includes the ten professional education courses or not, is considered the minimum educational requirement for qualification as a teacher in your state.

If you have all of the required education except the fifth year, you may deduct your expenses for the fifth year unless it will qualify you for a new trade or business. See *Education to Qualify for a New Trade or Business*, later.

Example 2. Assume the same facts as in Example 1. If you have a bachelor's degree and only six professional education courses, you may deduct the cost of four more education courses. Because a bachelor's degree is the minimum requirement for qualification as a teacher, you have already met the minimum requirements, even though you do not have all of the required courses.

Example 3. Assume the same facts as in Example 1. If you are hired with only 3 years of college, you cannot deduct your expenses for the courses you take that lead to a bachelor's degree. This includes those in education. These courses are nonqualifying education because they are required to meet the minimum education for employment as a teacher.

Example 4. You have a bachelor's degree and you work as a temporary instructor at a university. At the same time, you take graduate courses toward an advanced degree. The rules of the university state that you may become a faculty member only if you get a graduate degree. Also, you may keep your job as an instructor only as long as you show satisfactory progress toward getting this degree. You cannot deduct the cost of the graduate courses because you have not met the minimum educational requirements to qualify you as a faculty member.

Certification in a new state. Once you have met the minimum educational requirements for your state, you may deduct expenses of additional education to certify you in a new state.

Example. You hold a permanent teaching certificate in State A and are employed as a teacher in that state for several years. You move to State B and are promptly hired as a school teacher. You are required, however, to complete certain prescribed courses to get a permanent teaching certificate in State B. You may deduct the costs of these additional courses because the teaching position in State B involves the same general kind of work for which you were qualified in State A. You have already met the minimum requirements for teaching and have not entered a new trade or business.

Professor's research costs. College or university professors may be able to deduct research and related expenses that pertain to their area of competence. The research must be undertaken as a means of carrying out the duties expected of a professor and without expectation of profit apart from salary. Minimum requirements of education have been met, regardless of tenure, when the professor meets the school's criteria for employment.

Education to Qualify for a New Trade or Business

You cannot deduct expenses for education if the education is part of a program of study that can qualify you for a new trade or business. However, if you change duties but still do the same general work you do now, the new duties are not considered a new trade or business.

Example 1. You are an accountant. Your employer requires you to get a law degree at your own expense. You register at a law school for the regular curriculum that leads to a law degree, even though you do not intend to become a lawyer. Because this degree will qualify you for a new trade or business, you cannot deduct your expenses.

Example 2. You are a general practitioner of medicine. You take a 2-week course to review new developments in several specialized fields of medicine. You may deduct the expenses for the course because it maintains or improves skills required in your profession. The course does not qualify you for a new profession.

Example 3. While working in the private practice of psychiatry, you enter a program to study and train at an accredited psychoanalytic institute. The program will lead to qualifying you to practice psychoanalysis. You may deduct your expenses for the study and training because it maintains or improves skills required in your present profession. The psychoanalytic training does not qualify you for a new profession.

Bar or CPA review course. You cannot deduct expenses of taking a review course to prepare for the bar examination or the certified public accountant (CPA) examination. The cost of the review course is a personal expense.

Qualifications for teachers. All teaching and related duties are considered the same general kind of work. If you change duties in any of the following ways, it is not considered as a change to a new business.

- Elementary school teacher to secondary school teacher.
- Teacher of one subject, such as biology, to teacher of another subject, such as art.
- Classroom teacher to guidance counselor.
- Classroom teacher to school administrator.

What Educational Expenses Are Deductible

If your education meets the requirements described earlier under *Qualifying Education*, you may be able to deduct your educational expenses.

Deductible expenses. These expenses of education include:

1) Tuition, books, supplies, lab fees, and similar items.
2) Certain transportation and travel costs.
3) Other educational expenses, such as costs of correspondence courses, tutoring, formal training, plus research and typing when writing a paper as part of an educational program.

Nondeductible expenses. Educational expenses do ***not*** include personal or capital expenses. For example, you cannot deduct the dollar value of vacation time or annual leave you take to attend classes. This amount is a personal expense.

Transportation Expenses

If your educational expenses qualify for deduction, you can claim local transportation costs of going directly from work to school. If you are regularly employed and go to school on a strictly ***temporary basis***, you can also deduct

the costs of returning from school to home. A temporary basis is irregular or short-term attendance, generally a matter of days or weeks.

If you go directly from home to school on a temporary basis, you can deduct the round-trip costs of transportation in going from your home to school to home. This is true regardless of the location of the school, the distance traveled, or whether you attend school on non-work days.

Transportation expenses include the actual costs of bus, subway, cab, or other fares, as well as the costs of using your own car. Parking and tolls are also included. Transportation expenses do not include amounts spent for travel, meals, or lodging while you are away from home overnight.

If you use your car for transportation to school, you can deduct your actual expenses, or use the standard mileage rate to figure the amount you can deduct. See *Car Expenses* in Chapter 28 for information on using the standard mileage rate or figuring other expenses of using a car.

Example 1. You regularly work in Camden, New Jersey, and also attend school every night for 3 weeks to take a course that improves your job skills. Since you are attending school on a short-term basis, you can deduct your daily round-trip transportation expenses in going between home and school. This is true regardless of the distance traveled.

Example 2. Assume the same facts as in Example 1 except that on certain nights you go directly from work to school and then home. You can deduct your transportation expenses from your regular work site to school and then home.

Example 3. Assume the same facts as in Example 1 except that you attend the school for 6 consecutive Saturdays, non-work days. Since you are attending school on a short-term basis, you can deduct your round-trip transportation expenses in going between home and school.

Example 4. Assume the same facts as in Example 1 except that you attend classes twice a week for one year. Since your attendance in school is not considered temporary, you cannot deduct your transportation expenses in going between home and school. However, if you go directly to school from work, you can deduct the transportation expenses of going from work to school.

Travel Expenses

You may deduct expenses for travel, meals, and lodging if you travel overnight to obtain qualified education and the main purpose of the trip is to attend the work-related course or seminar. However, you cannot deduct expenses for personal activities, such as sightseeing, visiting, or entertaining.

If your travel away from home is mainly personal, you cannot deduct all of your expenses for travel, meals, and lodging. However, during the time you attend the qualified educational activities, you may deduct your expenses for meals and lodging.

To find out whether a trip's purpose is mainly personal or mainly educational, compare the amount of time spent on personal activities with the amount of time spent on educational activities.

Example 1. John works in Newark, New Jersey. He traveled to Chicago to take a deductible one-week course at the request of his employer. While there, he took a sightseeing trip, entertained some personal friends, and took a side trip to Pleasantville for a day. Since the trip was mainly for business, he can deduct his round-trip airfare to Chicago, but he cannot deduct his transportation expenses of going to Pleasantville. Only the meals and lodging connected with his educational activities can be claimed as educational expenses.

Example 2. Dave works in Nashville and recently traveled to California to take a deductible 2-week seminar. While there, he spent an additional 6 weeks on personal activities. These facts indicate that his main purpose was to take a vacation. He cannot deduct his round-trip airfare or his meals and lodging for the 6 weeks. He may deduct only his expenses for meals and lodging for the 2 weeks he attended the seminar.

Meal expenses. If your educational expenses qualify for deduction, you may deduct the cost of meals that qualify as travel expenses of education.

80% limit. You can only deduct 80% of your business-related meals that were not reimbursed by your employer and that qualify for deduction. This includes meals while traveling away from home to obtain your education. You must use Form 2106 to apply the 80% limit.

If your educational expenses include expenses for travel, see *Travel Expenses* in Chapter 28.

Travel as Education

You ***cannot deduct*** the cost of travel that in itself is a form of education even though the travel may be directly related to your duties in your work or business.

Example. You are a French language teacher. While on sabbatical leave granted for travel, you traveled through France to improve your knowledge of the French language. You chose your itinerary and most of your activities to improve your French language skills. You cannot deduct your travel expenses as educational expenses, even though you spent most of your time visiting French schools and families, attending movies or plays, and learning French in similar activities.

Expenses Relating to Tax-Exempt Income

Some qualified educational assistance you receive may be tax-exempt income. Since you do not pay tax on this income, you may not be able to deduct the related expenses. Examples of tax-exempt income include scholarships, veteran's educational assistance, and employee assistance plans. If you received assistance from any of these sources, see *Expenses Relating to Tax-Exempt Income* in Publication 508.

How to Report Educational Expenses and Reimbursements

To deduct expenses of work-related education, you must take into account all of the following.

- Your expenses must be for qualified education.
- You must file Form 1040.
- You must itemize your deductions on Schedule A (Form 1040) if you are an employee. Your educational expenses are deducted on line 20 as a miscellaneous deduction. You can only deduct your expenses that are over 2% of adjusted gross income.
- You may need to complete Form 2106 if your expenses for education include meals and transportation expenses or if you receive reimbursement from your employer. (Read the upcoming discussion under *Form 2106* for more details.)

If you are a qualified performing artist, you may deduct work-related educational expenses, even if you do not itemize your deductions. See *Performing Artists* in Publication 529, *Miscellaneous Deductions*, for more information about the expenses of performing artists.

Form 2106. Employee business expenses, including educational expenses, are reported on Form 2106. Use this form to figure your allowable travel, transportation, meal, and other work-related expenses of education. To deduct these expenses, complete Part I of Form 2106 and enter the result on Schedule A (Form 1040) as a miscellaneous itemized deduction. (Use Part II only if you have personal vehicle expenses.) Part I of Form 2106 has three steps:

- Step 1 of Part I shows your total business expenses. Lines 1 through 3 are for travel and transportation expenses that are related to your qualifying education. Line 4 is for educational expenses such as tuition and books. Line 5 is for meals while traveling away from home to obtain education.
- Step 2 shows amounts your employer gave you (your reimbursement) for the expenses listed in Step 1.
- Step 3 figures the expenses to deduct on Schedule A (Form 1040). If your employer did not reimburse you for work-related meals, your deduction is limited to 80% of your expenses. This allowable amount is figured on lines 9 through 11. The allowable meal expenses are added to your other unreimbursed expenses and the total is entered on line 20 of Schedule A (Form 1040).

Exception. You do not have to complete Form 2106 if ***either*** of the following applies:

- You adequately account to your employer with an account book, diary, or similar statement ***and*** your work-related expenses equal your reimbursement. (Do not deduct the expenses or report the reimbursement as income.)
- You are not deducting any expenses for travel, transportation, meals, or entertainment, ***and*** you were not reimbursed for any expenses you claim. (This includes educational expenses such as tuition, books, and lab fees. List the expenses directly on line 20 of Schedule A of Form 1040.)

Schedule A (Form 1040). Unreimbursed educational expenses, or expenses that are more than the amount reimbursed by your employer, are entered on line 20 of Schedule A (Form 1040). Generally, you must ***first use Form 2106*** to figure the amount to enter on line 20.

To claim these educational expenses, you must be able to itemize your deductions on Schedule A (Form 1040). You can only deduct the amount of miscellaneous deductions that is more than 2% of your adjusted gross income. This 2% limit is applied after all other deduction limits have been applied (such as the 80% limit on meal expenses, discussed earlier).

Reimbursement. How you report your reimbursement for qualified educational expenses depends on the type of your employer's reimbursement or allowance arrangement. See *If You Were Reimbursed* in Chapter 28 for information about how to treat reimbursements and adequately account to your employer.

Recordkeeping

You must keep proof to support your claim to a deduction as long as your income tax return can be examined. Generally, you should keep your records for 3 years from the date of filing the return and claiming the deduction. For specific information about keeping records of business expenses, see *Records* in Chapter 28.

30. Miscellaneous Deductions

Important Change for 1990

Cellular telephones. Beginning in 1990, you must use special rules to figure your deduction for a cellular telephone you used in a trade or business or as an employee.

You can deduct certain miscellaneous expenses on Schedule A (Form 1040). These expenses consist mainly of unreimbursed employee business expenses and expenses of producing taxable income. These deductions are in addition to the itemized deductions for medical and dental expenses, taxes, interest, charitable contributions, moving expenses, and casualty or theft losses.

The first part of this chapter contains lists of deductible expenses and nondeductible expenses. The lists are presented in the following order:

1) Deductions subject to the 2% limit,
2) Deductions not subject to the 2% limit, and
3) Nondeductible expenses.

The remaining parts of this chapter provide detailed information on the various deductible expenses and explain how they should be reported on your return.

List of Miscellaneous Deductions Subject To the 2% Limit

You can claim the following expenses only to the extent that the total you claim is more than 2% of your adjusted gross income. Some of the more common expenses listed are discussed later.

Unreimbursed employee business expenses:

- Deductible employment-related education
- Depreciation on a home computer or cellular telephone your employer requires you to use in your work
- Dues to professional societies
- Job search expenses in your present occupation
- Laboratory breakage fees
- Liquidated damages paid to former employer for breach of employment contract
- Malpractice insurance premiums
- Medical examinations required by employer
- Occupational taxes paid by an employee
- Part of home used regularly and exclusively in work
- Passport for business trip
- Research expenses of a college professor
- Small tools and supplies used in your work
- Subscriptions to professional journals and trade magazines related to your work
- Travel, transportation, entertainment, and gift expenses that are unreimbursed and related to your work
- Union dues and expenses
- Work clothes and uniforms if required and not suitable for everyday use

Other expenses:

- Appraisal fees for a casualty loss or charitable contribution
- Clerical help and office rent in caring for investments
- Custodial and trust administration fees in connection with property held for producing income
- Depreciation on home computers to the extent used for investments
- Fees to collect interest and dividends
- Hobby expenses, but generally not more than hobby income
- Indirect miscellaneous deductions passed through grantor trusts, partnerships, and S corporations
- Investment fees and expenses
- Legal fees related to producing or collecting taxable income, doing or keeping your job, or for tax advice
- Repayment of social security benefits
- Safe deposit box rental
- Tax advice and preparation fees
- Trustee's fees for your IRA, if separately billed and paid

List of Miscellaneous Deductions Not Subject To the 2% Limit

- Gambling losses to the extent of gambling winnings
- Federal estate tax on income in respect of a decedent
- Amortizable premium on taxable bonds purchased before October 23, 1986
- Deduction for repayment of substantial amounts under a claim of right
- Unrecovered investment in pension
- Impairment-related work expenses of persons with disabilities

List of Nondeductible Expenses

- Adoption expenses
- Base rate of first residential telephone line
- Burial or funeral expenses
- Campaign expenses
- Capital expenses
- Certain fees and licenses, such as car licenses, marriage licenses, and dog tags
- Check-writing fees
- Commuting expenses (but see *Transportation Expenses* in Chapter 26)
- Fines and penalties, such as parking tickets
- Gifts to influence legislation
- Health spa expenses
- Hobby losses
- Home repairs, insurance, and rent
- Illegal bribes and kickbacks
- Life insurance premiums
- Losses from the sale of your home, furniture, personal car, etc.
- Lost or misplaced cash or property (but see *Mislaid or lost property* under *Theft* in Chapter 26)
- Lunches and meals while working late
- Personal legal expenses
- Personal, living, or family expenses
- Political contributions
- Professional accreditation fees
- Relief fund contributions for fellow employees
- Self-improvement expenses
- Stockholders' meeting, expenses of attending
- Tax-exempt income expenses
- Voluntary unemployment benefit fund contributions
- Wristwatches

Deductions Subject To the 2% Limit

Most miscellaneous itemized deductions are deductible only to the extent the total of all of these deductions is more than 2% of your adjusted gross income. Miscellaneous deductions that are not subject to the limit are discussed later under *Deductions Not Subject To the 2% Limit.*

Deductions subject to the 2% limit are discussed in the two general categories that are shown on Schedule A (Form 1040): unreimbursed employee expenses, and other expenses. Your deduction is the excess of the total of the allowable deductions in these two categories over 2% of your adjusted gross income. The 2% limit is applied after any other deduction limit (such as the 80% limit on meals and entertainment) is applied. See *How To Report,* later, for more information on applying the limit.

Exception for performing artists. Although most unreimbursed employee expenses are subject to the 2% limit, there is an exception for unreimbursed business expenses of certain performing artists. See *Performing Artists* in Publication 529, *Miscellaneous Deductions.*

Unreimbursed Employee Business Expenses

If you are an employee and have business expenses that are not reimbursed or that are more than the amount reimbursed by your employer, you can generally deduct them only as a miscellaneous deduction (subject to the 2% limit) on Schedule A (Form 1040). If you received a Form W–2 with the box on line 6 checked to indicate "Statutory employee," do not use Schedule A to deduct your expenses. See *Statutory employees,* in Publication 529.

Your "reimbursed" employee business expenses are treated as not reimbursed if your employer's reimbursement or other expense allowance arrangement either:

- Does not require you to adequately account for your expenses to the person providing the reimbursement, or
- Allows you to keep any reimbursement or allowance in excess of the expenses adequately accounted for.

Form 2106. File Form 2106, *Employee Business Expenses,* if you are an employee and are deducting expenses attributable to your job.

Exceptions. Do not complete Form 2106 if any of the following apply:

- You account to your employer by means of an account book, diary, or similar statement, your business expenses equal your reimbursement, and the reimbursement is not included on your Form W-2 as if it were wages. If this exception applies, do not deduct the expenses or report the reimbursement as income.
- You are not claiming job expenses for travel, transportation, meals or entertainment, and you were not reimbursed for any of the expenses you do claim. (Examples are educational expenses, uniforms, home office costs, and union dues.) If this exception applies, list the expenses directly on line 20 of Schedule A (Form 1040).
- You are a statutory employee.

Travel, Transportation, Meals, Entertainment, and Gift Expenses

If you are an employee and have ordinary and necessary travel, transportation, meal, entertainment, and gift expenses related to your work, you may be able to deduct these expenses on your income tax return.

For more information on travel, transportation, meals, entertainment, and gift expenses and reimbursements, see Chapter 28.

Work Clothes and Uniforms

You can deduct the cost and upkeep of work clothes only if they are required as a condition of your employment and are not suitable for everyday wear. To qualify for the deduction, both conditions must be met. It is not enough that you wear distinctive clothing; it must be specifically required by your employer. Nor is it enough that you do not wear your work clothes away from work; the clothing must not be suitable for taking the place of your regular clothing.

Examples of occupations in which you may be required to wear uniforms which qualify are: delivery workers, firefighters, health care workers, law enforcement officers, letter carriers, professional athletes, and transportation workers (air, rail, bus, etc.).

Musicians and entertainers can deduct the cost of theatrical clothing and accessories if they are not suitable for ordinary use.

However, work clothing consisting of white cap, white shirt or white jacket, white bib overalls, and standard work shoes, which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform. Similarly, the cost and maintenance of blue work clothes worn by a welder at the request of a foreman are not deductible.

Protective clothing. You can deduct the cost of protective clothing required in your work, such as safety shoes or boots, safety glasses, hard hats, and work gloves.

Examples of occupations in which you may be required to wear safety items are: carpenters, cement workers, chemical workers, electricians, fishers, linemen, machinists, oil field workers, pipe fitters, steamfitters, and truck drivers.

Military uniforms. You generally cannot deduct the cost of your uniforms if you are on full-time active duty in the armed forces. However, if you are an armed forces reservist, you can deduct the unreimbursed cost of your uniform if military regulations restrict you from wearing it except while on duty as a reservist. In figuring the deduction, you must reduce the cost by any nontaxable allowance you receive for these expenses.

If local military rules do not allow you to wear fatigue uniforms when you are off duty, you can deduct the amount by which the cost of buying and keeping up these uniforms is more than the uniform allowance you receive.

If you are a student at an armed forces academy, you cannot deduct the cost of your uniforms if they replace regular clothing. You can deduct the cost of insignia, shoulder boards, and related items.

You can deduct the cost of your uniforms if you are a civilian faculty or staff member of a military school.

Home Computers and Cellular Telephones

You may be able to claim a depreciation deduction and a section 179 deduction for a home computer or cellular telephone provided you use these items more than 50% of the time for business (in your work as an employee) and you meet the following tests (these deductions did not apply to a cellular telephone before 1990). Your use of these items must be:

- For the convenience of your employer, and
- Required as a condition of your employment so that you can properly perform your duties as an employee.

If you use the computer to produce income other than from a business, such as from investments, see *Home computer* under *Other Expenses*, later.

For more information about the rules and exceptions to the rules affecting the allowable deductions for a home computer or cellular telephone see *Home Computers and Cellular Telephones* in Publication 529, *Miscellaneous Deductions*.

Reporting and substantiation requirements. To claim the deduction for your home computer or cellular telephone you must complete Part V of **Form 4562**, *Depreciation and Amortization* and attach it to your tax return. Also, you must keep adequate records to prove your business use of these items.

For more information about depreciation (including the section 179 deduction) and recordkeeping requirements, get Publication 534, *Depreciation*.

Union Dues and Expenses

You can deduct dues and initiation fees you pay for union membership.

Assessments for benefit payments to unemployed union members are deductible. However, you cannot deduct the part of the assessments or contributions that provides funds for the payment of sick, accident, or death benefits. Also, you cannot deduct contributions to a pension fund even if the union requires you to make such contributions.

Job Search Expenses

You may be able to deduct certain expenses you have in looking for a new job in your present occupation, even if you do not get a new job. You cannot deduct these expenses if you are looking for a job in a new occupation, even if you get the job.

If you are unemployed, the kind of work you did for your past employer is your occupation. If there is a substantial break between the time of your past job and your looking for a new one, you cannot deduct your expenses.

You cannot deduct your expenses if you are seeking employment for the first time, even if you get the job.

Employment agency fees. If you pay employment agency fees in looking for a new job in your same occupation, you can deduct these expenses as an itemized deduction. If, in a later year, your employer pays you back for employment agency fees, you must include the amount you receive in gross income to the extent of your tax benefit in the earlier year (as explained under *Recoveries* in Publication 525, *Taxable and Nontaxable Income*). If your employer pays the fees directly to the employment agency and you were not responsible for them, you do not include them in your gross income.

Résumé. Amounts you spend for typing, printing, and mailing copies of a résumé to prospective employers are deductible as a miscellaneous deduction if you spent the amounts in looking for a new job in your present occupation.

Travel and transportation expenses. If you travel to an area and, while there, you look for a new job in your present occupation and also engage in personal activities, travel expenses to and from this area may be deductible as a miscellaneous itemized deduction. To be deductible, the trip must be primarily to look for a new job. The amount of time you spend on personal activity compared to the amount of time you spend in looking for work is important in determining whether the trip is primarily personal. See *Travel Expenses* in Chapter 28 for more information.

Even if the travel expenses to and from an area are not deductible, the expenses of looking for a new job in your present occupation, while in the area, are deductible.

Repayment of Income Aid Payment

If you repay a lump-sum income aid payment that you received and included in income in an earlier year, you can deduct the repayment on Schedule A (Form 1040). An "income aid payment" is one that is received under an employer's plan to aid employees who lose their jobs due to lack of work.

Using Your Home in Your Work

If you are not self-employed and you use a part of your home ***regularly and exclusively*** for business purposes, you may be able to deduct a part of the operating and depreciation expenses on your home. You cannot deduct any part of personal expenses that are for family household purposes.

Use tests. You may deduct certain expenses for operating a part of your home only if that part of your home is used ***regularly and exclusively*** as:

- Your principal place of business for any trade or business in which you engage,
- A place to meet or deal with your patients, clients, or customers in the normal course of your trade or business, or
- A separate structure that is used in your trade or business and is not attached to your house or residence.

In addition, if the regular and exclusive business use is for your work as an employee, the use must be ***for the convenience of your employer*** and not just appropriate and helpful in your job.

If you claim a home office deduction based on meeting with patients, clients, or customers, you must physically meet with them on your premises, and your meetings with them must be substantial and integral to the conduct of your business. Occasional meetings and telephone calls are insufficient.

You may have a principal place of business for ***each*** trade or business in which you engage. For example, as a teacher, your principal place of business for teaching is the

school. If you also engage in a retail sales business and use part of your home as your principal place of business for retail selling, expenses for this business use of your home may be deductible.

The business use of your home. You cannot deduct any operating or depreciation expenses for the use of your home if the use is for a profit-seeking activity that is not a trade or business. For example, you cannot deduct these expenses if you use a part of your home, even though regularly and exclusively, to read financial periodicals and reports, clip bond coupons, and perform similar investment activities on your own behalf, because these activities are not a trade or business.

The use of a part of your home for ***both personal and business purposes*** does not meet the exclusive use test and you cannot deduct expenses for business use. If, for example, you use the den of your home to write legal briefs, prepare tax returns, or perform similar activities, as well as for personal purposes, you cannot deduct any expenses for the business use of that part of your home. There is an exception for the use of your home as a day-care center.

Use of your home as a day-care center. The exclusive use requirement does not apply when you regularly use your home, or any part of your home, in your business of providing day-care services to children, persons with disabilities, or the elderly.

Storage use. You can deduct certain business expenses for the part of your home you regularly use to store goods you sell at retail or wholesale in your trade or business. Your home must be the only fixed location of that business. This storage space can have other uses, but the space must be a specific area.

Percentage of business use. To figure the percentage of your home used for business, compare the square feet of space used for business to the total square feet in your home. Or, if the rooms in your home are approximately the same size, you may compare the number of rooms used for business to the total number of rooms in your home. Generally, you figure the business part of your expenses by applying the percentage to the total of each expense.

If you use part of your home as a day-care center and you make any use of that part for personal purposes, you must also figure what percentage of available time you actually use it for business. You then apply the business percentage of time to the business part of your expenses.

Limit on deduction for business use. The deduction for the business use of your home is limited to the gross income from that business use minus the sum of:

1) The business percentage of the otherwise deductible mortgage interest, real estate taxes, and casualty and theft losses, and
2) The expenses for your business that are not attributable to the use of your home (for example, salaries or supplies).

This limit is discussed under *Deduction Limit* in Publication 587, *Business Use of Your Home.*

The cost of repairs. You can deduct the cost of painting and repairing rooms that are used only for business purposes. You cannot deduct the costs of painting and repairing rooms used for other purposes.

You can deduct a part of the cost of painting the outside of your home or repairing the roof based on the percentage of business use. However, you cannot deduct expenses for lawn care and landscaping.

Depreciation. You can deduct depreciation on the part of your home used for business.

Home leased to employer. If you lease any part of your home to your employer, you cannot claim home office expenses for any period you use any part of your home to perform services for your employer.

How to report. If you are an employee, you generally report your expenses for the business use of your home (insurance, maintenance, utilities, depreciation) on Form 2106. If business use of the home expenses were your only employee business expenses in 1990, and your employer did not pay you for any of them, do not fill out Form 2106. In this case, enter your total expenses directly on line 20 of your Schedule A.

If you do not receive any reimbursement for the business use of your home expenses or if your expenses exceed reimbursement, you can deduct the expenses only if you itemize deductions on Schedule A. Include the office-in-home expenses for mortgage interest under *Interest You Paid,* real estate taxes under *Taxes You Paid,* and casualty and theft losses under *Casualty and Theft Losses* on Schedule A. You enter the rest of your office-in-the-home expenses, as well as any other employee business expenses, as miscellaneous itemized deductions on line 20 of Schedule A, subject to the 2% of adjusted gross income limit.

You can include the remaining real estate taxes, mortgage interest, or casualty losses on the appropriate lines of your Schedule A (Form 1040).

Records. You should keep records that will give the information needed to figure the deduction according to these rules. Also keep canceled checks and receipts of the expenses paid to prove the deductions you claim.

For more information on using your home in your work and how to compute your allowable deduction, get Publication 587.

Other Expenses

You can deduct certain other expenses as miscellaneous itemized deductions subject to the 2% of adjusted gross income limit. They are listed on line 21 of Schedule A (Form 1040). These are expenses you pay:

1) To produce or collect income,
2) To manage, conserve, or maintain property held for producing income, or
3) To determine, contest, pay, or claim a refund of any tax.

The expenses must be directly related to the income or income-producing property, and the income must be taxable to you.

Indirect deductions of pass-through entities (partnerships and S corporations). Deductions of pass-through entities are passed through to the partners or shareholders. If the deductions are miscellaneous itemized deductions, they are generally subject to the 2% limit.

Information returns. You should receive information returns from these entities. Partnerships and S corporations issue **Schedule K–1,** which lists the items and amounts you must report, and identifies the tax return schedules and lines to use.

Example. If you are a member of an investment club partnership that is formed solely to invest in securities, and its income is solely from taxable dividends, interest, and gains from sales of securities, you can deduct your share of the partnership's operating expenses as a miscellaneous itemized deduction subject to the 2% limit. However, if the investment club partnership has investments that also produce nontaxable income, you cannot deduct your share of the partnership's expenses that produce the nontaxable income. You should receive a copy of **Schedule K–1** (Form 1065), *Partner's Share of Income, Credits, Deductions, etc.*

Allocated expenses of mutual funds. The allocable investment expenses of nonpublicly-offered mutual funds are subject to the 2% limit. Those of publicly-offered mutual funds are not subject to the 2% limit.

Nonpublicly-offered mutual funds report to you your share of gross income and investment expenses. You can only claim the expenses as a miscellaneous itemized deduction subject to the 2% limit.

- *Publicly-offered* mutual funds will send you a Form 1099–DIV, or substitute form, showing the net amount of dividend income (gross dividends minus investment expenses). This net figure is the amount you report on your return.

"Publicly-offered" mutual funds are funds that are usually traded on an established securities market. Contact your mutual fund if you are not sure if your fund is publicly offered.

Clerical help and office rent. You can deduct office expenses, such as rent and clerical help, that you incur in connection with your investments and collecting the taxable income on them.

Custodian fees and service charges to subscribers in a dividend reinvestment plan are deductible. These are for services including:

- Holding shares acquired through a plan,
- Collecting and reinvesting cash dividends, and
- Keeping individual records and providing detailed statements of accounts.

Service fees. You can deduct fees you pay to a broker, bank, trustee, or similar agent to collect your taxable bond interest or dividends on shares of stock. But you cannot deduct a fee you pay to a broker to buy investment property, such as stocks or bonds. You must add the fee to the cost of the property.

You must offset against the selling price a fee you pay to a broker to sell securities. You cannot deduct the fee unless you are a dealer in securities.

Home computer. You can deduct depreciation on your home computer to the extent you use it for the production of income (for example, managing your investments that produce taxable income). However, certain limits may apply, as explained under *Partial Business Use of Listed Property* in Publication 534. If you work as an employee and use the computer in that work, see *Home Computers and Cellular Telephones,* earlier, under *Unreimbursed Employee Business Expenses.*

Investment fees and expenses paid for managing your investments are deductible if they relate to investments that produce taxable income.

IRA trustee's administrative fees that are billed separately and that you paid in connection with your individual retirement arrangement (IRA) are deductible, if they are ordinary and necessary. These fees do not include capital expenditures (such as brokers' commissions that you must add to the cost of securities you buy through brokers). These fees also do not include disguised IRA contributions. These trustee's fees are not subject to the annual dollar limit on contributions you can make to an IRA. Deduct them on line 21, Schedule A (Form 1040), not with your IRA deduction. For more information about IRAs, get Publication 590, *Individual Retirement Arrangements (IRAs).*

Legal expenses that you have to produce taxable income are usually deductible. You may have legal expenses that are related to either doing or keeping your job.

You can deduct legal fees you paid to defend yourself against criminal charges arising out of your trade or business.

You can deduct legal expenses for tax advice related to a divorce if the bill specifies how much is for tax advice and if it is determined in a reasonable way. You also may have legal expenses to collect taxable alimony. Because you pay tax on this income, you can deduct your legal costs as an expense necessary to produce taxable income.

You can also deduct legal fees you pay in connection with the determination, collection, or refund of any tax.

Safe deposit box rent is deductible if you use the box to store taxable income-producing stocks, bonds, or investment-related papers and documents. You cannot deduct the rent if you use the box only for jewelry or other personal items or for tax-exempt securities.

Repayments of social security benefits. For information on how to deduct your repayments of certain social security benefits, get Publication 915, *Social Security Benefits and Equivalent Railroad Retirement Benefits.*

Appraisal fees are deductible if you pay them to determine the amount of a casualty loss or the fair market value of donated property.

Tax preparation fees usually are deductible in the year you pay them. Thus, you can deduct on your 1990 return fees paid in 1990 for preparing your 1989 return.

Loss on deposits in an insolvent or bankrupt financial institution. For information on whether, and if so, how you may deduct a loss of your deposit in a qualified financial institution, see *Loss on deposits in an insolvent or bankrupt financial institution* in Chapter 16.

Deductions Not Subject To the 2% Limit

The following expenses are deductible as miscellaneous itemized deductions. However, they are not subject to the 2% limit. Report these expenses on line 26, Schedule A (Form 1040).

Federal estate tax on income in respect of a decedent. You can deduct the federal estate tax attributable to income in respect of a decedent that is ordinary income and that you as a beneficiary include in your gross income. Income in respect of a decedent is gross income that the decedent had a right to receive, could have received had death not occurred, and that was not properly includable in the decedent's final income tax return. See Chapter 4 for more information.

Amortizable premium on taxable bonds. Bond premium is the amount you pay for bonds that is greater than the face value of the bonds. You can choose to amortize the premium on taxable bonds.

For a bond purchased before October 23, 1986, the amortization of the premium is a miscellaneous itemized deduction not subject to the 2% limit.

For a bond purchased after October 22, 1986, and before January 1, 1988, the amortization of the premium is investment interest expense subject to the investment interest limit, unless you choose to treat it as an offset to interest income.

For a bond acquired after December 31, 1987, the amortization of the premium is an offset to interest income on the bond rather than a separate interest deduction item.

For more information see *Bond Premium Amortization* in Publication 550, *Investment Income and Expenses.*

Gambling losses to the extent of gambling winnings. You cannot deduct more than the gambling winnings you report on line 22, Form 1040. You must keep an accurate diary or similar record of your losses and winnings, and you must be able to prove the amounts of your winnings and losses by receipt, ticket, or statement. For more information about gambling winnings, see *Gambling winnings* in Chapter 13.

Unrecovered investment in pension. If a retiree had contributed to the cost of a pension or annuity, a part of each payment received can be excluded from income as a tax-free return of the retiree's investment. If the retiree dies before the entire investment is returned, any unrecovered investment is allowed as a deduction on the retiree's final return. See Chapter 11 for more information.

Repayments under claim of right. If you had to repay more than $3,000 that you included in income in an earlier year because at the time you thought you had an unrestricted right to it, you may be able to deduct the amount you repaid. See Chapter 13 for more information.

Impairment-related work expenses. If you have a physical or mental disability that limits your being employed, or substantially limits one or more of your major life activities, such as performing manual tasks, walking, speaking, breathing, learning, and working, your impairment-related work expenses are deductible.

Impairment-related work expenses are expenses for attendant care services at your place of work and other expenses in connection with your place of work that are necessary for you to be able to work and that are ordinary and necessary in your kind of work.

If you are an employee, you enter impairment-related work expenses on Form 2106. Enter the amount from line 11 of Form 2106 on Schedule A (Form 1040), line 26, instead of Schedule A, line 20. Also get *Instructions for Form 2106.*

If you are self-employed, you deduct impairment-related work expenses on Schedule C (Form 1040).

How To Report

You must itemize deductions to be able to claim miscellaneous deductions on Schedule A (Form 1040).

If you have unreimbursed employee business expenses, generally you must first complete Form 2106. You should carry over the amount on line 11 of Form 2106 to Schedule A (Form 1040), line 20. Attach the completed Form 2106 to Form 1040.

Any other miscellaneous deductions subject to the 2% limit should be claimed on line 21 of Schedule A (Form 1040). However, if none of your employee business expenses are reimbursed by your employer and you are not claiming any meal, entertainment, travel, or transportation expenses, you do not have to complete Form 2106. Instead, list your employee business expenses on line 20, Schedule A (Form 1040).

If you have miscellaneous deductions *not* subject to the 2% limit, you should claim these amounts on line 26 of Schedule A (Form 1040).

Nondeductible Expenses

The following expenses are not deductible.

Adoption expenses you paid for the adoption of a child are not deductible.

Campaign expenses of a candidate for any office, even if the candidate is running for reelection to the office, are not deductible. These include qualification and registration fees for primary elections.

Legal fees paid to defend charges that arise from participation in a political campaign are not deductible.

Check-writing fees. If you have a personal checking account, you cannot deduct fees charged by the bank for the privilege of writing checks, even if the account pays interest.

Commuting expenses to and from your main or regular place of work are not deductible. If you haul tools, instruments, etc., in your car to and from work, you can only deduct additional costs, such as renting a trailer that is towed by your vehicle. See Chapter 28.

Fees and licenses. You cannot deduct amounts paid for car licenses, marriage licenses, dog tags, etc.

Fines or penalties you pay to a governmental unit for violating a law are not deductible. Examples include parking tickets, tax penalties, and penalties deducted from teachers' paychecks after an illegal strike.

Gifts or amounts spent to influence the general public on legislative matters, elections, or referenda are not deductible.

Health spa expenses are not deductible, even if there is a job requirement to stay in excellent physical condition, such as might be required of a law enforcement officer.

Insurance premiums you pay or that are placed in escrow for your home, such as fire and liability or mortgage insurance, are not deductible. Premiums you pay on your life insurance or personal disability insurance are not deductible. Premiums you pay on life insurance policies assigned as alimony may be deductible as alimony.

Lunches or meals while working late, except while traveling away from home, are not deductible.

Personal legal expenses, such as the following, are not deductible:

- Defense of a breach of promise (to marry) suit,
- Defense of civil or criminal charges resulting from a personal relationship,
- Defense of property claims in a divorce,
- Preparation of a will, and
- Property settlement in a divorce.

This is true even though a result of the legal proceeding is the loss of income-producing property.

In some cases legal expenses are part of the basis of property. See Chapter 15.

Political contributions. You cannot deduct contributions made to a political candidate, a campaign committee, or a newsletter fund.

Professional accreditation fees, such as the following, are not deductible:

- Accounting certificate fees paid for the initial right to practice accounting,
- Bar exam fees and incidental expenses in securing admission to the bar, and
- Medical and dental license fees paid to get initial licensing.

Residential telephone service. You cannot deduct any charge (including taxes) for basic local telephone service for the first telephone line to your residence.

Self-improvement. You cannot deduct expenses for increasing your personal prestige or establishing your professional reputation.

Stockholders' meetings. You cannot deduct transportation and other expenses you pay to attend stockholders' meetings of companies in which you own stock but have no other interest. You cannot deduct these expenses even if you are attending the meeting to get information that would be useful in making future investments.

You cannot deduct any expenses for attending a convention, seminar, or similar meeting for investment purposes.

Tax-exempt income. You cannot deduct expenses to produce tax-exempt income. You cannot deduct interest on a debt incurred or continued to buy or carry tax-exempt securities.

If you have expenses to produce both taxable and tax-exempt income, but you cannot identify the expenses that produce each type of income, you must divide them to determine the amount that you can deduct.

Example. During the year you received taxable interest of $4,800 and tax-exempt interest of $1,200. You had expenses of $500 during the year to earn this income. If you cannot specifically identify the amount of each expense item for each income item, you must allocate 80% ($4,800/$6,000) of the expense to taxable interest and 20% ($1,200/$6,000) to tax-exempt interest. You can deduct, subject to the 2% limit, expenses of $400.

Voluntary unemployment benefit fund contributions you make to a union fund or a private fund are not deductible. If you make contributions to a state unemployment fund, see *Income Taxes* in Chapter 23.

Part VI
Figuring Your Taxes and Credits

The chapters in this part explain how to figure your tax and how to figure the tax of certain children who have more than $1,000 of investment income. They also discuss tax credits. Credits, unlike deductions, are subtracted directly from your tax and therefore reduce your tax dollar for dollar. There are tax credits for the elderly or for the disabled, for the expense of having your child or disabled dependent cared for so that you can work, and for other kinds of expenses.

31. How to Figure Your Tax

Important Changes for 1990

Form 1040A. This form has been expanded to include IRA payments, pensions and annuities, taxable social security and railroad retirement benefits, credit for the elderly or the disabled, estimated payments, a line to report advance earned income credit payments, and the election to apply all or part of your 1990 refund to 1991 estimated tax. See *Form 1040A*, later.

Form 1040. This form now includes a line for reporting advance earned income credit payments. See *Form 1040*, later.

This chapter explains the steps you need to take to figure your taxes, whether you file Form 1040EZ, Form 1040A, or Form 1040. It also helps you choose whether you should itemize deductions or take the standard deduction. In addition, it covers a portion of the alternative minimum tax (Form 6251).

How you figure your tax depends on which form you use and whether you itemize your deductions.

Form 1040EZ

If you file Form 1040EZ, you must figure your taxable income before you can find your tax.

Taxable income (line 5, Form 1040EZ) is the total of your wages, salaries, tips, scholarships or fellowship grants to the extent taxable, and interest, minus your standard deduction and the deduction for your personal exemption (line 4). The total of your standard deduction ($3,250) and your personal exemption ($2,050) is $5,300, unless you can be claimed as a dependent by another taxpayer. (See *Standard Deduction for Dependents* in Chapter 21.) You enter this amount on line 4. However, if you can be claimed as a dependent by another taxpayer, check the *Yes* box on line 4 and complete the worksheet on the back of Form 1040EZ. Enter the result from line E of the worksheet on line 4 (Form 1040EZ).

Tax withheld. After you have figured your taxable income, you enter the total of your federal income tax withheld on line 6. This amount is shown on your Form(s) W–2.

Also include on line 6 any excess social security or railroad retirement tax withheld. You can use the worksheet in the instructions for Form 1040EZ to figure your excess social security taxes. Show the amount of this excess to the left of line 6 and write "Excess SST." See Chapter 35 for a discussion of excess withholding.

To find your tax, use the Tax Table at the back of this publication or in the instructions for Form 1040EZ. Find the income line that includes your taxable income shown on line 5 of your Form 1040EZ. Next, find the column heading for single (if using Publication 17) and read down the column. The amount shown where the income line and filing status column (single) meet is your tax. Enter it on line 7.

Refund or amount you owe. If line 6 is larger than line 7, subtract line 7 from line 6 and enter the result on line 8. This is the amount of your refund. For information on refunds, see *Refunds* in Chapter 1.

If line 7 is larger than line 6, subtract line 6 from line 7 and enter the result on line 9. This is the amount you owe. For information on how to pay, see *Amount You Owe* in Chapter 1.

A filled-in Form 1040EZ is shown in Chapter 36.

Form 1040A

If you file Form 1040A, you must find your adjusted gross income and your taxable income before you can figure your tax.

Adjusted gross income (line 16, Form 1040A) is your total income (line 14) minus your IRA deduction, and your spouse's IRA deduction if you file a joint return. You can figure your IRA deduction by completing the worksheet in the instructions for Form 1040A. Also see Chapter 19.

Taxable income (line 22) is your adjusted gross income (line 16) minus your standard deduction (line 19) and the deduction for your exemptions (line 21). For information on your standard deduction, see *Standard Deduction*, later, and Chapter 21. To figure the deduction for your exemptions, multiply $2,050 by the number of exemptions claimed on line 6e.

Tax, credits, and payments. To find your tax, use the Tax Table at the back of this publication or in the instructions for Form 1040A.

Note. If you were under age 14 on January 1, 1991, and had more than $1,000 of investment income, you cannot use the Tax Table. Instead, you must check the box marked "Form 8615" on line 23. Use Form 8615, *Tax For Children Under Age 14 Who Have Investment Income of More Than $1,000*, to compute your tax.

Tax. In the Tax Table, find the income line that includes your taxable income shown on line 22. Next, find the column heading that describes your filing status and read down the column. The amount shown where the income line and filing status column meet is your tax. Enter it on line 23 and check the box marked "Tax Table."

Credits. After you have figured your tax, figure any credit for child and dependent care expenses (line 24a) or credit for the elderly or the disabled (line 24b) you may have. If you claim the credit for child and dependent care expenses, you must complete all applicable parts of Schedule 2 (Form 1040A) and attach it to your return. If you claim the credit for the elderly or the disabled, you must complete Schedule 3 (Form 1040A) and attach it to your return. Add lines 24a and 24b together and enter the result on line 24c. Subtract your total credits (line 24c) from your tax (line 23) and enter the result on line 25. For information on the credit for child and dependent care expenses, see Chapter 33. For information on credit for the elderly or the disabled, see Chapter 34.

If you received advance earned income credit payments, the amount will be shown on your Form(s) W–2, Box 8. Enter the amount of these payments on line 26. For more information, see *Advance Earned Income Credit* in Chapter 35.

Payments. Your next step is to figure your total payments. On line 28a, you enter the total federal income tax withheld from your pay. This amount is shown in Box 9 of your Form(s) W–2.

If you received a 1990 Form 1099 showing income tax withheld on dividends or interest income, check the box and include the amount withheld in the total on line 28a.

On line 28b enter your 1990 estimated tax payments and any amount applied from your 1989 federal income tax return.

On line 28c, you enter your earned income credit. Figure the amount of your earned income credit by completing either the worksheet in the instructions for Form 1040A or the worksheet in Chapter 35. For information on the earned income credit, see Chapter 35.

On line 28d include any excess social security or railroad retirement tax withheld. Write "Excess SST" and the amount in the space to the left of line 28d. See Chapter 35 for a discussion on this.

Add lines 28a, 28b, and 28c together and enter this total on line 28d. This sum is your total payments.

Refund or Amount You Owe

After you have your total tax (line 27) and your total payments (line 28d), you must determine if you are due a tax refund or if you owe additional tax.

Refund

If line 28d is more than line 27, subtract line 27 from line 28d and enter the result on line 29. This is the amount of your refund. For information on refunds, see *Refunds* in Chapter 1.

If you want the entire amount on line 29 refunded, enter that amount on line 30. Enter on line 30 the exact amount you want refunded. However, if you want all or part of your refund applied to your 1991 estimated tax, you must enter the appropriate amount on line 31. The amount on line 31 will be credited to your 1991 estimated taxes unless you request us to apply it to your spouse's account. This request should include your spouse's social security number. The amount on line 31 generally cannot be refunded to you until you file a tax return for 1991.

Amount you owe

If line 27 is larger than line 28d, subtract line 28d from line 27 and enter the result on line 32. This is the amount you owe. For information on how to pay, see *Amount You Owe* in Chapter 1.

A filled-in Form 1040A is shown in Chapter 37.

Form 1040

If you file Form 1040, you must compute your adjusted gross income and taxable income before you can figure your tax.

Adjusted Gross Income

Adjusted gross income (line 31, Form 1040) is your total income (line 23) minus any adjustments from the following:

- IRA deduction for you (line 24a), and for your spouse (line 24b). See Chapter 19.
- Deduction for one-half of your self-employment tax (line 25). See Publication 533, *Self-Employment Tax.*
- Self-employed health insurance deduction (line 26). See Chapter 22.
- Keogh retirement plan and self-employed SEP deduction (line 27). See Publication 560, *Retirement Plans for the Self-Employed.*
- Penalty on early withdrawal of savings (line 28). See Chapter 8.
- Alimony paid. You must show the recipient's social security number in the space provided on line 29. See Chapter 20.
- Certain expenses of qualified performing artists. See Chapter 30.
- Foreign housing deduction. See Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.*
- Jury duty pay given to your employer. See Chapter 13.
- Amortization of the costs of forestation or reforestation if you do not have to file Schedule C or Schedule F. See Publication 535, *Business Expenses.*
- Certain required repayments of supplemental unemployment benefits. See Chapter 6.

Taxable Income

There are two ways to figure the amount of your taxable income (line 37). You can itemize your deductions on Schedule A (Form 1040) or take the standard deduction.

Itemizing Your Deductions

You generally can choose to either itemize your deductions (such as medical expenses, taxes, interest, and casualty losses) on Schedule A (Form 1040) or take a standard deduction amount, whichever is greater.

You may be able to itemize your deductions on Schedule A if you:

- Do not qualify for the standard deduction, or the amount you can claim is limited,
- Had large medical and dental expenses not covered by your insurance during the year,
- Paid interest and taxes,
- Had large unreimbursed employee business expenses or other miscellaneous deductions,
- Had unreimbursed moving expenses,
- Had large casualty or theft losses not covered by insurance,
- Made large contributions to qualified charities, and
- Have total itemized deductions that are more than the highest standard deduction amount to which you are otherwise entitled.

Some taxpayers itemize deductions because they do not qualify for the standard deduction or the amount they qualify for is limited (see Chapter 21).

If you decide to itemize your deductions, complete and attach Schedule A, and enter the amount from Schedule A, line 27, on Form 1040, line 34. Be sure to attach Schedule A to your return.

If you itemize your deductions, your taxable income (line 37 of Form 1040) is your adjusted gross income (line 32) minus your itemized deductions (line 34) and your exemptions (line 36).

Changing your mind. If you do not itemize your deductions and later find you should have itemized—or if you itemize and later find you should not have—you may change your return by filing Form 1040X, *Amended U.S. Individual Income Tax Return.*

If you and your spouse file separate returns, you can use the method that gives you both combined the lowest total tax, even though one of you separately may pay more. You ***both must use the same method*** of claiming deductions. If one itemizes deductions, the other should itemize also since he or she will not qualify for the standard deduction.

If you are married and filed separate returns, you may change your mind and either itemize deductions or take the standard deduction. However, both you and your spouse must make the same changes. You both must file an amended return and agree to assessment for any additional tax either one may owe as a result of the change.

Standard Deduction

The standard deduction reduces the amount of your income that is taxed and thus reduces the amount of tax you will pay. The standard deduction is based on your filing status and whether you are 65 or older or blind. It is not built into the Tax Table or the Tax Rate Schedules, but is figured separately.

65 or older or blind. If you are 65 or older or blind in 1990, you are entitled to a standard deduction amount which is more than the amount for taxpayers under 65 and not blind. For information on who qualifies for the higher standard deduction amount for age and blindness, see Chapter 21. The standard deduction amounts are given in the *standard deduction charts and worksheet* in Chapter 21.

Special rules. Your standard deduction is **zero** if:

- Your spouse itemizes deductions on a separate return,
- You are a dual-status or nonresident alien, or
- You have a short tax year.

If you can be claimed as a dependent on another person's return, your standard deduction may be limited. See *Standard Deduction for Dependents,* in Chapter 21.

Standard deduction amount. If you decide to take the standard deduction, show the amount on line 34 of Form 1040.

Use the *standard deduction charts and worksheet* in Chapter 21 or in the Form 1040 instructions to find your standard deduction amount.

If you take the standard deduction, your taxable income (line 37 of Form 1040) is your adjusted gross income (line 32) minus your standard deduction (line 34) and your exemptions (line 36).

Tax, Credits, and Payments

Most people use the Tax Table to figure their tax. However, you must use the Tax Rate Schedules to figure your tax if your taxable income is $50,000 or more.

Tax Table

The Tax Table is shown in the back of this publication and in the instructions for Form 1040.

To find your tax, read down the income column to the line that includes your taxable income as shown on line 37, Form 1040. Then read across the line to the column heading that describes your filing status. The amount shown where the income line and filing status column meet is your tax. Enter it on line 38, Form 1040, and check the box marked *Tax Table.*

Tax Rate Schedules

If your taxable income (line 37) is $50,000 or more, you must figure your tax by using Tax Rate Schedules X, Y–1, Y–2, or Z.

The tax rate schedules are shown at the back of this publication and in the Form 1040 instructions. Enter your tax on line 38, Form 1040, and check the box marked *Tax Rate Schedules.*

Form 8615

If you were under age 14 on January 1, 1990, and had more than $1,000 of investment income, you must compute your tax using Form 8615, *Tax For Children Under Age 14 Who Have Investment Income Of More Than $1,000.* For more information on this computation, see Chapter 32.

Note. Do not file Form 8615 if neither of your parents are alive on December 31, 1990. Also, do not file this form if your parents choose to include your income on their tax return.

Additional Taxes

If you owe any of the taxes shown on line 39 (Form 1040), attach the appropriate Form 4970, *Tax on Accumulation Distribution of Trusts* or Form 4972, *Tax on Lump-Sum Distributions.* On line 39, check the box that applies to you and enter the amount of additional taxes.

Credits

After you have figured your tax and entered the total of lines 38 and 39 on line 40 (Form 1040), you figure your credits and enter them on lines 41 through 46. Enter the total credits on line 46. Subtract line 46 from line 40. Enter the result on line 47.

Credit for child and dependent care expenses. Use Form 2441, *Child and Dependent Care Expenses,* to compute your credit and enter the credit on line 41. Information on this credit is in Chapter 33.

Credit for the elderly or the disabled. Enter on line 42 (Form 1040) the amount of this credit, which you compute on Schedule R. See Chapter 34 for more information.

Foreign tax credit. Enter on line 43 (Form 1040) the amount of foreign tax credit you computed on Form 1116. Foreign tax credit is discussed in Publication 514, *Foreign Tax Credit for Individuals.*

General business credit. Enter on line 44 (Form 1040) any general business credits you may have and check the appropriate box to identify which form you are attaching. If you do not have to use Form 3800, *General Business Credit,* check Box b and enter the form number for the credit form that you are using. See the instructions for Form 3800 for a discussion of business credits.

Credit for prior year minimum tax. Complete Form 8801, *Credit For Prior Year Minimum Tax,* if you paid alternative minimum tax in 1989 on deferred preference items. Enter the amount of the credit on line 45 (Form 1040), and attach Form 8801 to your tax return. For information on this credit, see Publication 909, *Alternative Minimum Tax for Individuals.*

Credit for fuel from a nonconventional source. Include the credit in the total for line 46. Write the amount and "FNS" on the dotted line next to line 46. Also attach a separate schedule showing how you figured the credit. See *Internal Revenue Code, section 29,* for further information.

Mortgage interest credit. Use Form 8396, *Mortgage Interest Credit* to figure the amount of the credit. Include this amount in the total for line 46. Write the amount and "MIC" on the dotted line next to line 46. See *Mortgage interest credit* under *Interest* in Publication 530, *Tax Information for Homeowners.*

Other Taxes

If you owe any of the taxes shown on lines 48 through 54, complete the lines that apply to you and enter your total on line 54.

Self-employment tax. If you (or your spouse if you file a joint return) have net earnings of $400 or more from self-employment, complete Schedule SE (Form 1040) and show any tax you owe on line 48. See Publication 533, *Self-Employment Tax,* for more information.

Alternative minimum tax. Use Form 6251 to see if you owe any alternative minimum tax. Enter your result on line 49 (Form 1040). The computation of this tax is discussed later in this chapter and in Publication 909.

Recapture taxes. If you are required to compute the recapture of either investment tax credit on Form 4255 or low-income housing credit on Form 8611, enter the amount on line 50 (Form 1040) and check the appropriate box.

Social security tax on tip income not reported to employer. Attach Form 4137, *Social Security Tax on Unreported Tip Income,* and show on line 51 (Form 1040) the tax due on tip income you did not report to your employer. See Chapter 7 for more information.

Tax on an IRA or a qualified retirement plan. If you:

- Owe a tax due to excess contributions to your IRA,
- Owe a tax on early distributions from your IRA or qualified retirement plan, annuity contract or modified endowment contract,
- Meet an exception to the 10% additional tax on early distributions,
- Owe a tax because you did not receive a minimum required distribution from your IRA or qualified retirement plan,
- Want to use the special grandfather rule to exempt certain excess distributions from the 15% excise tax, or
- Owe a tax on excess distributions from a qualified retirement plan,

You must complete Form 5329, *Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts,* and attach it to your return. Show the result on line 52 (Form 1040). See Chapter 19 for more information.

Include on line 53 any **advance earned income credit payments** you received in 1990. Your W-2 form(s) will show these payments in Box 8. Add lines 47 through 53. Put the total on line 54. Line 54 will be your total tax.

Section 72(m)(5) excess benefits. If you are or were a 5% owner of a business and you received a distribution of excess benefits from a qualified pension or annuity plan, you may have to pay a penalty tax of 10% of the excess benefits distribution. Include the amount of the penalty in your total for line 54. Also write the amount and "Section 72(m)(5)" on the dotted line next to line 54. See Publication 560, *Retirement Plans for the Self-Employed,* for more information.

Uncollected employee social security and RRTA tax on tips. If you did not have enough wages to cover the social security tax or railroad retirement (RRTA) tax due on tips you reported to your employer, include the amount shown on your W-2, Box 17, in the total for line 54. Also write the amount and "Uncollected Tax on Tips" on the dotted line next to line 54. See Chapter 7 for more information.

Golden parachute payments. If you received an excess parachute payment (EPP), you must pay a tax equal to 20% of this excess payment. Include the amount of this tax in your total for line 54. Also write the amount and "EPP" on the dotted line next to line 54. See *Form 1040 Instructions* for *Line 54* for more information.

Payments

Once you have figured your total tax on line 54, you must figure your total payments. On line 55, enter your federal income tax withheld. If line 55 includes amounts shown on a Form 1099, check the box on line 55. If you were subject to backup withholding, include the amount withheld on line 55. This amount is shown on your Forms W-2, W-2G, W-2P, and 1099-R.

If you made estimated tax payments for 1990, you enter the total of these payments on line 56. Also enter on line 56 any overpayment from your 1989 return that you applied to your 1990 estimated tax. Complete lines 57 through 62, if they apply. Add lines 55 through 62 and enter the result on line 62. These are your total payments.

Refund or Amount You Owe

After you have your total tax (line 54) and your total payments (line 62), you must determine if you are due a tax refund or if you owe additional tax.

Refund

If the amount on line 62 is larger than the amount on line 54, subtract line 54 from line 62 and enter the result on line 63. This is the amount of tax you have overpaid. If you want the entire amount refunded to you, enter the amount from line 63 on line 64. If you want all or part of your overpayment applied to your 1991 estimated tax, you must complete both lines 64 and 65. For information on refunds, see *Refunds,* in Chapter 1.

Amount You Owe

If the amount on line 54 is larger than the amount on line 62, subtract line 62 from line 54 and enter the result on line 66. This is the amount of tax you owe. For information on how to pay, see *Amount You Owe,* in Chapter 1.

Alternative Minimum Tax

The tax laws give special treatment to some kinds of income and allow special deductions and credits for some kinds of expenses. Taxpayers who benefit from these laws have to pay at least a minimum amount of tax through an additional tax.

This additional tax is called the ***alternative minimum tax (AMT).*** This tax has been broadened to include more taxpayers who pay little or no income tax, and strengthened to make sure that all taxpayers with economic income pay tax.

Alternative minimum taxable income is figured using your taxable income with certain ***adjustments*** and increased by the amount of any ***tax preference items*** you have. All tax preference items are added to taxable income.

You may have to pay the alternative minimum tax if your taxable income for regular tax purposes, combined with any of the adjustments and preference items that apply to you, total more than:

- $40,000 if you are married filing a joint return (or a qualifying widow(er)),
- $30,000 if your filing status is head of household, or
- $20,000 if you are married filing a separate return.

Adjustments to taxable income include:

- Addition of ***personal exemptions*** ,
- Addition of the ***standard deduction*** (if claimed).
- Addition of ***itemized deductions*** claimed for state and local taxes, certain interest, most miscellaneous deductions, and part of medical expenses,
- Subtraction of any ***refund of state and local taxes*** included in gross income,
- Change in amount of ***depreciation*** claimed on certain property,
- Change in method of determining income from ***long-term contracts*** entered into on or after March 1, 1986,
- Change in method of determining income from ***certain installment sales by dealers,***
- Change in method of determining ***net operating loss*** deduction, and
- Change in method of determining ***passive activity loss*** deduction.

Tax preference items include:

- That part of any deduction for ***depletion*** that is more than the adjusted basis of the property,
- Part of any deduction for ***intangible drilling costs*** if the deduction (minus the amount that could have been deducted if the cost were amortized over 120 months) is more than 65% of the net income from oil, gas, and geothermal properties,
- ***Tax-exempt interest*** on certain private activity bonds,
- Unrealized ***appreciation*** on donated long-term capital gain property, and
- Accelerated ***depreciation*** on certain property placed in service before 1987.

For more information about the alternative minimum tax and how to figure it, see Publication 909, *Alternative Minimum Tax for Individuals,* and **Form 6251,** *Alternative Minimum Tax—Individuals.*

Tax Figured by IRS

The IRS will figure your tax on Form 1040EZ, Form 1040A, or Form 1040.

Form 1040EZ

If you file your Form 1040EZ by April 15, 1991, you may choose to have the IRS figure your tax. Put your name and address label on your return. If you do not have a label, print (do not type) your name, address, and social security number in the spaces provided. If you want

one dollar of your taxes to go to the Presidential Election Campaign Fund, check the *Yes* box. Read lines 1 through 6 and fill in the lines that apply to you. Sign and date your return. Attach Copy B or the first copy of your Form W–2 to your return. Mail the return to the Internal Revenue Service Center for the area where you live.

Form 1040A

If you file Form 1040A by April 15, 1991, you may have the IRS figure your tax. Place your name and address label on your return or, if you do not have a label, fill in (print or type) your name, address, and social security number. If you are married, give the social security numbers of both spouses even if you file separately. Check the appropriate box or boxes for the Presidential Election Campaign Fund.

If you are required to use Form 8615, *Tax for Children Under Age 14 Who Have Investment Income Of More Than $1,000,* or if you want any of your refund applied to your 1991 estimated tax, IRS cannot figure your tax for you.

What to complete. Read lines 1 through 22 (Form 1040A) and fill in the lines that apply to you.

Read lines 24a, 26,and 28a (Form 1040A) and fill in the amounts if any of the lines apply to you. Complete and attach any schedules or forms asked for in the lines you completed.

Credit for child and dependent care expenses. If you can take this credit, complete Schedule 2 and attach it to your return. You must show on Schedule 2 the name, address, and identifying number of the person or organization who provided the care.

Advance earned income credit payment. If you received any advance earned income credit payment during 1990, enter the amount on line 26. Your Form(s) W–2 will show these payments in Box 8.

Credit for the elderly or the disabled. If you can take this credit, attach Schedule 3 to your return and write "CFE" in the space to the left of line 24b. Check the box on Schedule 3 for your filing status and age, and fill in line 11 and 13 of Part III, if applicable. Also complete Part II, if applicable.

Earned income credit. If you can take the earned income credit, as discussed in Chapter 35, the IRS will figure the credit for you. Write "EIC" in the space to the left of line 28c.

Form W–2. Attach Copy B or the first copy of your Form W–2 to your return.

Filing the return. Sign and date your return. Also fill in your occupation. If you are filing a joint return, both you and your spouse must sign it. Show both of your occupations on a joint return. Mail the return to the Internal Revenue Service Center for the area where you live.

Form 1040

You may choose to have the IRS figure your tax if you meet **all** of the conditions described below:

- All of your income for 1990 consists only of wages, salaries, tips, interest, dividends, taxable social security benefits, unemployment compensation, IRA distributions, pensions, or annuities,
- Your taxable income on line 37, Form 1040, is not more than $50,000,
- You do not itemize your deductions,
- You do not file Form 8615, *Tax for Children Under Age 14 Who Have Investment Income of More Than $1,000,*
- You do not file Form 8814, *Parent's Election To Report Child's Interest and Dividends,*
- You do not use Form 2555, *Foreign Earned Income,*
- You do not file Form 6251, *Alternative Minimum Tax — Individuals,*
- You do not want any of your refund applied to your 1991 estimated tax, and
- You file your return by April 15, 1991.

Name, address, and social security number. Put your name and address label on your return. If you do not have a label, fill in (print or type) your name, address, and social security number. If you are married, give the social security numbers of both spouses even if you file separately.

Check the appropriate *Yes* or *No* box or boxes for the Presidential Election Campaign Fund.

What to complete. Read lines 1 through 37 (Form 1040) and fill in the lines that apply to you.

If you are filing a joint return, use the space under the words *Adjustments to Income* on the front of your return to show your taxable income and your spouse's taxable income separately.

Read lines 39 through 62 (Form 1040). Fill in the lines that apply to you, but do not fill in the *Total* lines. Please be sure to fill in line 55 for Federal income tax withheld.

Fill in any forms or schedules asked for on the lines you completed and attach them to your return when you file it.

Credits. If you can take the credit for the elderly or the disabled, as discussed in Chapter 34, attach Schedule R. Write "CFE" on the dotted line next to line 42 of Form 1040. On Schedule R, enter your name and social security number, check the box for your filing status and age, and fill in lines 11 and 13 of Part III, if applicable. Also complete Part II of Schedule R, if applicable.

If you can take the earned income credit, as discussed in Chapter 35, write "EIC" on the dotted line next to line 57 of Form 1040.

Filing the return. Attach Copy B or the first copy of your Forms W–2 to your return.

Be sure to sign and date your return and show your occupation. If you are filing a joint return, both you and your spouse must sign it. Mail your return to the Internal Revenue Service Center for the area where you live.

If the IRS figures your tax and you paid too much, you will receive a refund. If you did not pay enough, you will receive a bill for the balance. You may avoid interest or the penalty for late payment if you pay the bill within 30 days of the date of the bill or by the due date for your return, whichever is later.

Note. If you did not pay enough tax, you may be charged a penalty for underpayment of estimated tax. See *Underpayment Penalty* in Chapter 5.

Changing your mind. If you choose to have the IRS figure your tax, you may later change your mind by filing an amended return.

32. Tax on Investment Income of Certain Minor Children

This chapter explains two special tax rules that apply to certain investment income of a child under age 14:

1) The child's parent may be able to choose to include the child's interest and dividend income on the parent's return rather than file a return for the child (see *Parent's Election to Include Child's Income,* later).
2) If the child's interest, dividends, and other investment income total more than $1,000, part of that income may be taxed at the parent's tax rate (see *Child's Return Filed,* later).

For this purpose, the term "child" includes a legally adopted child and a stepchild. These rules apply whether or not the child is a dependent.

These rules ***do not*** apply if:

- The child is not required to file a tax return (see *Who Must File,* in Chapter 1), or
- Neither of the child's parents were living at the end of the tax year.

Which Parent's Return to Use

The following discussions explain which parent's tax return must be used when applying the special tax rules for the investment income of a child under 14. Only that parent can make the election described later under *Parent's Election to Include Child's Income,* and only that parent's tax rate and other return information is used in the computations explained later under *Child's Return Filed.*

Child's parents married. If the child's parents are married to each other and file a joint return, use the joint return to apply the special rules. If they live together but file separate returns, use the return of the parent with the greater taxable income.

Parents not living together. If the child's parents are married but not living together, and the parent with whom the child lives (the custodial parent) qualifies to be considered unmarried, use the return of the custodial parent. If the custodial parent does not qualify to be considered unmarried, use the return of the parent with the greater taxable income.

For an explanation of how a married person qualifies to be considered unmarried, see *Head of Household* in Chapter 2.

Child's parents divorced. If the child's parents are divorced and the parent who had custody of the child for the greater part of the year (the custodial parent) has not remarried, use the return of the custodial parent to apply the special rules.

Custodial parent remarried. If the custodial parent has remarried, the stepparent (rather than the noncustodial parent) is treated as the child's other parent in applying the special rules. Therefore, the earlier discussion under *Child's parents married* applies.

Child's parents never married. If the child's parents did not marry each other, but lived together all year, use the return of the parent with the greater taxable income to apply the special rules. If the parents did not live together all year, the rules explained earlier under *Child's parents divorced* apply.

Widows and widowers. Widows and widowers must use the rules explained earlier under *Child's parents divorced* to apply the special rules.

Parent's Election to Include Child's Income

If you elect to include your child's interest and dividend income on your tax return, the child is not required to file a return.

You can make this election for 1990 only if ***all*** the following conditions are met.

1) Your child was under age 14 on January 1, 1991.
2) Your child had income only from interest and dividends (including Alaska Permanent Fund dividends).
3) The dividend and interest income was more than $500 and less than $5,000.
4) No estimated tax payments were made for 1990 under your child's name and social security number.
5) No federal income tax was withheld from your child's income under the backup withholding rules.
6) You are the parent whose return must be used when applying the special tax rules for children under 14. (See *Which Parent's Return to Use*, earlier.)

Make the election by attaching **Form 8814,** *Parent's Election To Report Child's Interest and Dividends*, to your Form 1040 or Form 1040NR. (If you file Form 8814, you ***cannot*** file Form 1040A or Form 1040EZ.) Attach a separate Form 8814 for each child for whom you make the election.

Tax effect of election. Using Form 8814 does not affect the tax rate applied to your child's income. Therefore, your family's total tax will usually be the same, whether your child files a return or you include his or her income on your return.

However, using Form 8814 may result in more total tax if your child could have taken deductions you cannot take, or if you have items on your return that are affected by your adjusted gross income. You should figure the tax both ways, then use the method that results in less tax.

Deductions you cannot take. If you use Form 8814, you cannot take any of the following deductions that could have been taken on your child's return:

1) Additional $800 standard deduction if your child was blind,
2) Deduction for penalty on early withdrawal of your child's savings, and
3) Itemized deductions (such as your child's investment expenses or charitable contributions).

Increased adjusted gross income. If you use Form 8814 to add your child's income to yours, your increased adjusted gross income may reduce certain items on your return, including the following:

1) Deduction for contributions to an individual retirement arrangement (IRA),
2) Itemized deductions for medical expenses, casualty and theft losses, and certain miscellaneous expenses, and
3) Credit for child and dependent care expenses.

Penalty for underpayment of estimated tax. If you make this election for 1990 and did not have enough tax withheld or pay enough estimated tax to cover the tax you owe, you may be subject to a penalty. If you plan to make this election for 1991, you may need to increase your federal income tax withholding or your estimated tax payments to avoid the penalty. See Chapter 5 for information.

Figuring Amount of Child's Income to Report

Step 1 of Form 8814 is used to figure the amount of your child's income to report on your return. Only the amount in excess of $1,000 is added to your income. Include the amount from line 5, Form 8814, in the total on line 22, Form 1040 or Form 1040NR. In the space next to line 22, write "Form 8814" and the total from line 5 of all your Forms 8814.

Alternative minimum tax. If your child received any interest from private activity bonds that is a tax preference item, include it as a tax preference item when figuring your alternative minimum tax. Get Publication 909, *Alternative Minimum Tax for Individuals*, for information.

Capital gain distributions. Include in the total on line 2a of Form 8814 any capital gain dividend distributions your child received. Treat these capital gain distributions in the same way as ordinary dividends, unless you file Schedule D (Form 1040) to report capital gains and losses.

If you file Schedule D, part or all of these capital gain distributions should be reported on that schedule (where they may be offset by your capital losses). Get Publication 929, *Tax Rules for Children and Dependents*, and use the worksheet under *Capital gain distributions* to figure the amount to report on Schedule D and the amount to report on line 5, Form 8814.

Figuring Additional Tax

Step 2 of Form 8814 is used to figure the tax on the amount of your child's interest and dividends that you do not include in your income ($1,000 or less), minus a $500 standard deduction. This tax is added to the tax figured on your taxable income.

This additional tax is figured at the lowest tax rate (15%) on the ***smaller*** of:

1) Your child's gross income minus $500, or
2) $500 ($1,000 minus $500).

The tax cannot be more than $75 (15% × $500).

Include the amount from line 6, Form 8814, in the total on line 38, Form 1040, or line 36, Form 1040NR. On Form 1040, enter the total from line 8 of all your Forms 8814 in the space provided next to line 38. On Form 1040NR, write "Form 8814" and the total of the line 8 amounts in the space provided next to line 36.

Illustrated Example

The facts in this example are illustrated on the filled-in Form 8814 on the next page.

David and Linda Parks are married and will file separate tax returns for 1990. Their only child, Philip, is 8. For 1990, Philip received a Form 1099-INT showing $3,200 taxable interest income and a Form 1099-DIV showing $300 ordinary dividends. His parents decide to include that income on one of their returns so that they will not have to file a return for Philip.

First, David and Linda each figure their taxable income (Form 1040, line 37) without regard to Philip's income. David's taxable income is $41,700 and Linda's is $59,300. Because her taxable income is greater, Linda can elect to include Philip's income on her return.

On Form 8814, Linda enters her name and social security number, then Philip's name and social security number. She enters Philip's interest income, $3,200, on line 1a. Philip had no tax-exempt interest income, so she leaves line 1b blank. Linda enters Philip's ordinary dividends, $300, on line 2a. Philip did not have any nontaxable distributions, so she leaves line 2b blank and enters $300 on line 2c.

Linda adds the amounts on lines 1a and 2c and enters the result, $3,500, on line 3. From that amount she subtracts the $1,000 base amount shown on line 4 and enters the result, $2,500, on line 5. This is the portion of Philip's income that Linda must add to her income.

Linda includes the $2,500 on line 22 of her Form 1040 and in the space next to that line writes "Form 8814—$2,500." Adding that amount to her income increases each of the amounts on lines 23, 31, 32, 35, and 37 of her Form 1040 by $2,500. Therefore, her revised taxable income on line 37 is $61,800 ($59,300 + $2,500).

On Form 8814, Linda subtracts the $500 shown on line 6 from the $3,500 on line 3 and enters the result, $3,000, on line 7. Because that amount is $500 or more, she enters $75 on line 8. This is the tax on the $1,000 of Philip's income that Linda did not add to her income. She must add this additional tax to the tax figured on her revised taxable income.

Linda enters $75 in the space provided next to line 38 of her Form 1040. She figures the tax, $16,325, on her $61,800 revised taxable income, adds $75, and enters the $16,400 total on line 38.

Linda attaches Form 8814 to her Form 1040.

Child's Return Filed (Parent's Election Not Made)

Part of a child's investment income may be subject to tax at the parent's tax rate if:

1) The child was under age 14 on January 1, 1991, and
2) The child's investment income was more than $1,000.

If the child's parent does not or cannot choose to include the child's income on his or her return, figure the child's tax on **Form 8615,** *Tax for Children Under Age 14 Who Have Investment Income of More Than $1,000.* Attach the form to the child's Form 1040, Form 1040A, or Form 1040NR.

On Form 8615, enter the names and social security numbers of the child and the parent in the spaces provided. (If the parents filed a joint return, enter the name and social security number of the parent who is listed first on the joint return.) Check the box for the parent's filing status and show the number of exemptions claimed on the parent's return. Then figure the child's tax on that form in these three steps:

Step 1. Figure the child's net investment income.

Step 2. Figure a tentative tax on the net investment income based on the parent's tax rate.

Step 3. Figure the child's tax.

Alternative minimum tax. A child may be subject to alternative minimum tax (AMT) if he or she has certain items given preferential

Form **8814**

Department of the Treasury
Internal Revenue Service

Parent's Election To Report Child's Interest and Dividends

► See instructions below and on back.

► Attach to Parent's Form 1040 or Form 1040NR.

OMB No. 1545-1128

1990

Attachment Sequence No. 40

General Instructions

Purpose of Form.—Use this form if you are a parent and choose to report the income of your child on your return. If you do, the child will not have to file a return. You can file this form only if your child:

- Was under age 14 on January 1, 1991;
- Had income only from interest and dividends (including Alaska Permanent Fund dividends);
- Had gross income for 1990 that was more than $500 but less than $5,000;
- Had no estimated tax payments for 1990;
- Did not have any overpayment of tax shown on his or her 1989 return applied to the 1990 return; AND
- Had no Federal income tax withheld from his or her income (backup withholding).

The parent(s) must also qualify as explained on page 2 of these instructions.

Step 1 is used to figure the amount of the child's income to report on the parent's return. **Step 2** is used to figure an additional tax that must be added to the parent's tax.

A separate Form 8814 must be filed for each child whose income the parent chooses to report.

Caution: *The Federal income tax on your child's income may be less if you file a tax return for the child instead of making this election. This is because you cannot take certain deductions that your child would be entitled to on his or her own return. For details, see* ***Deductions You May Not Take*** *on page 2.*

(Instructions continue on back.)

Name(s) shown on parent's return	Your social security number
Linda L. Parks	428 00 2407
Child's name (first, initial, and last)	**Child's social security number**
Philip P. Parks	682 00 9120

Caution: If more than one Form 8814 is attached, check here . . . . . ► ☐

Step 1 Figure amount of child's interest and dividend income to report on your return

1a	Enter your child's **taxable** interest income. If this amount is different than the amounts shown on the child's Forms 1099-INT and 1099-OID, see the instructions	1a	3,200
b	Enter your child's **tax-exempt** interest income. Do **NOT** include this amount on line 1a (1b)		
2a	Enter your child's gross dividends (including any Alaska Permanent Fund dividends). If none, enter zero on line 2c and go to line 3. If your child received any capital gain distributions or dividends as a nominee, see the instructions	2a	300
b	Enter your child's nontaxable distributions (from Form 1099-DIV, Box 1d) included on line 2a (2b)		
c	Subtract line 2b from line 2a. Enter the result	2c	300
3	Add lines 1a and 2c. Enter the total. If the total is $1,000 or less, skip lines 4 and 5 and go to line 6. If the total is $5,000 or more, **do not** file this form. Your child **must** file his or her own return to report the income	3	3,500
4	Base amount	4	1,000 00
5	Subtract line 4 from line 3. Enter the result. (If filing more than one Form 8814, see the instructions.) Also include this amount in the total on Form 1040, line 22, or Form 1040NR, line 22. In the space next to line 22, write "Form 8814" and show the amount. Go on to line 6 ►	5	2,500

Step 2 Figure your tax on the first $1,000 of child's interest and dividend income

6	Amount not taxed	6	500 00
7	Subtract line 6 from line 3. Enter the result. If the result is zero or less, enter zero	7	3,000
8	**Tax.** • If the amount on line 7 is $500 or more, enter $75 here. (Also, see the **Note** below for where to enter it on your tax return.) • If the amount on line 7 is less than $500, multiply the amount on line 7 by 15% (.15). Enter the result here. (Also, see the **Note** below for where to enter it on your tax return.)	8	75

Note: *Include the amount from line 8 in the tax you enter on Form 1040, line 38, or Form 1040NR, line 36. On Form 1040, also enter the amount from line 8 in the space provided next to line 38. On Form 1040NR, enter the amount from line 8 and "Form 8814" next to line 36. (If filing more than one Form 8814, see the instructions.)*

treatment under the tax laws or certain adjustments to taxable income that total more than a base amount. See *Alternative Minimum Tax* in Chapter 31.

For information on special limits that apply to a child who files Form 6251, see *Limit on AMT* under *Alternative Minimum Tax* in Publication 929.

Parent's return information. See *Which Parent's Return to Use*, earlier, for information on which parent's return information must be used on Form 8615. If the parent and the child do not have the same tax year, complete the form using the information on the parent's return for the tax year that ends in the child's taxable year.

If the information needed from the parent's return is not known by the time the child's return is due (usually April 15), file the return using estimates, or request an extension of time to file. If the information is not available, the child (or the child's legal representative) can request it from the IRS. See *Parent's return information not available* under *Child's Return Filed* in Publication 929 for more information.

Figuring Net Investment Income

The first step in figuring a child's tax using Form 8615 is to figure the child's net investment income. To do that, first figure the child's gross (total) investment income.

Investment Income

Investment income generally includes all income other than salaries, wages, and other amounts received as pay for work actually done. It includes interest, dividends, capital gains, certain distributions from trusts, and the taxable part of social security payments and pension payments.

For this purpose, investment income includes only amounts that the child must include in total income. Nontaxable investment income, such as tax-exempt interest and the nontaxable part of social security and pension payments, is not included.

A child's investment income includes all income produced by property belonging to the child, regardless of whether the property was transferred to the child or purchased by the child, and regardless of when the property was transferred or purchased or who transferred it. Investment income includes amounts produced by assets the child obtained with earned income (such as interest on a savings account into which the child deposited wages).

A child's investment income includes income produced by property given as a gift to the child under the Uniform Gift to Minors Act.

Example. Phil Black, 13, received the following income:

Dividends — $600

Wages — $2,100

Taxable interest — $1,200

Tax-exempt interest — $100

Net capital gains — $100.

Phil's investment income is $1,900. This is the total of the dividends ($600), taxable interest ($1,200), and net capital gains ($100). His wages are earned (not investment) income because they are pay received for work actually done. His tax-exempt interest is not included because it is nontaxable.

Trust income. If a child is the beneficiary of a trust, distributions of taxable interest, dividends, capital gains, and other investment income from the trust are investment income to the child.

Net Investment Income

A child's net investment income is generally his or her gross (total) investment income reduced by the sum of the following three items:

1) Adjustments to income attributable to the investment income (such as the penalty on early withdrawal of savings), plus
2) $500, plus
3) The greater of $500 or the child's itemized deductions that are ***directly connected*** (defined later) with the production of his or her investment income.

Example 1. Elenora, 8, has investment income of $16,000 and an early withdrawal penalty of $100. She has itemized deductions of $1,100 that are directly connected with the production of her investment income. Elenora's net investment income is $14,300. This is her total investment income of $16,000, reduced by $1,700. The $1,700 is the sum of the early withdrawal penalty ($100), plus $500, plus the directly-connected itemized deductions ($1,100).

Example 2. Roger, 12, has investment income of $8,000, no adjustments to income, and itemized deductions of $300 that are directly connected with his investment income. His net investment income is $7,000. This is his total investment income of $8,000, reduced by $1,000 ($500 + $500).

His investment income is reduced by $1,000 because he has no adjustments to income and his directly-connected itemized deductions are not more than $500.

Directly-connected itemized deductions. Itemized deductions are directly connected with the production of investment income if they are for expenses paid to produce or collect taxable income or to manage, conserve, or maintain property held for producing income. These expenses include custodian fees and service charges, service fees to collect taxable interest and dividends, and certain investment counsel fees. They are deducted on Schedule A (Form 1040) to the extent that they, plus certain other miscellaneous itemized deductions, are more than 2% of adjusted gross income. See Chapter 30 for more information about the 2% of adjusted gross income limit on miscellaneous itemized deductions.

Net investment income limited to taxable income. A child's net investment income cannot be more than his or her taxable income. If the child's taxable income is less than the amount figured as previously explained, the child's net investment income is the same amount as the taxable income.

Completing Step 1 of Form 8615

A child's net investment income is figured on lines 1 through 5 of Form 8615.

Line 1 (investment income). If your child had ***investment income only,*** enter the adjusted gross income shown on the child's return. Adjusted gross income is shown on line 31 of Form 1040 or line 16 of Form 1040A. Form 1040EZ cannot be used if Form 8615 must be filed.

If the child had ***earned income,*** figure the amount to enter on line 1 of Form 8615 by using the worksheet in the instructions for the form.

However, if the child has excluded any foreign earned income or deducted either a loss from self-employment or a net operating loss from another year, add these amounts to the result on line 3 of the worksheet. For more information and an alternate worksheet, see *Completing Step 1 of Form 8615* under *Figuring Net Investment Income* in Publication 929.

Figuring Tentative Tax At Parent's Tax Rate

The tentative tax is the difference in the tax on the parent's taxable income figured with and without the child's net investment income. Figure it as follows:

1) Figure the tax on the total of the parent's taxable income plus the child's net investment income at the parent's tax rate.
2) Figure the tax on the parent's taxable income without including the child's net investment income.
3) Subtract the tax in (2) from the tax in (1). This is the tentative tax.

When making these computations, do not take into account the child's net investment income in figuring any exclusion, deduction, or credit on the parent's return.

Special rule. See *Trusts* under *Figuring Tentative Tax at Parent's Tax Rate* in Publication 929 for information about a special rule that may apply if the parent is the grantor of a trust.

More Than One Child

If the tax return information of the child's parent is used on Forms 8615 for other children (including adopted children and stepchildren), include the net investment income of all these children when figuring the tentative tax. Then allocate the tentative tax to each child according to the child's share of the total net investment income.

If the net investment income of the other children is not available when the return is due, either file the return using estimates or request an extension of time to file. Extensions are discussed under *Extensions of Time to File* in Chapter 1.

Allocation of tentative tax. Allocate the tentative tax to each child by multiplying the total tentative tax by a fraction. The numerator (top number) of the fraction is the child's net investment income. The denominator (bottom number) is the total of the net investment income of all the children. The result of each multiplication is that child's share of the tentative tax.

Example. The Oaks' two children, Bill and Patty, ages 11 and 12, have $2,000 and $3,000 of net investment income. Tax on their incomes must be figured at their parents' rate. On Form 8615, Bill's and Patty's net investment incomes are combined and the total ($5,000) is added to their parents' taxable income shown on their joint tax return. The difference between (1) the tax figured on the total of their parents' taxable income plus the children's net investment income and (2) the actual tax on their parents' return is $1,750. This difference (the tentative tax) must be allocated between Bill and Patty.

The amount allocated to Bill is $700.

$$\frac{\$2,000}{\$5,000} \times \$1,750 = \$700$$

The amount allocated to Patty is $1,050.

$$\frac{\$3,000}{\$5,000} \times \$1,750 = \$1,050$$

Completing Step 2 of Form 8615

The tentative tax based on the parent's tax rate is figured on lines 6 through 13 of Form 8615.

Line 9 (tax figured on parent's taxable income plus children's net investment income). Use the Tax Table or Tax Rate Schedules and the parent's filing status to figure the amount to enter on line 9 of Form 8615.

If the amount on line 8 is ***less than $50,000,*** use the Tax Table to figure the amount to enter on line 9. If the amount on line 8 is ***$50,000 or more,*** use the Tax Rate Schedules.

Figuring the Child's Tax

The final step in figuring a child's tax using Form 8615 is to determine the ***larger*** of:

1) The total of:
   a) The child's share of the tentative tax based on the parent's tax rate, plus
   b) The tax on the child's taxable income in excess of net investment income, figured at the child's tax rate, or
2) The tax on the child's taxable income, figured at the child's tax rate.

Completing Step 3 of Form 8615

The child's tax is figured on lines 14 through 18 of Form 8615.

Lines 15 and 17 (tax at child's rate). Use the Tax Table for single filing status or Tax Rate Schedule X, whichever applies, to figure the amounts to enter on lines 15 and 17.

Illustrated Example

The following example includes a completed Form 8615.

John and Laura Brown have one child, Sara. She is 13 and has $2,300 taxable interest and dividend income and $1,500 earned income. She does not itemize deductions. John and Laura file a joint return with John's name and social security number listed first. They claim three exemptions, including an exemption for Sara, on their return.

Because Sara has both earned and unearned income and her gross income is more than $500, she must file a tax return. Because she is under age 14 and has more than $1,000 investment income, part of her income may be subject to tax at her parents' rate. A completed Form 8615 must be attached to her return.

Sara's father, John, fills out Sara's return for her.

John enters his name and social security number on Sara's Form 8615 because his name and number are listed first on the joint return he and Laura are filing. He checks the box for married filing jointly and enters "3" in the box for the number of exemptions claimed.

He enters Sara's investment income, $2,300, on line 1. Sara does not itemize deductions, so John enters $1,000 on line 2. He enters $1,300 on line 3 ($2,300 – $1,000).

Sara's taxable income, as shown on line 22 of her Form 1040A, is $2,300. This is her total income ($3,900) minus her standard deduction ($1,500). Her standard deduction is limited to the amount of her earned income. John enters $2,300 on line 4.

John compares the amounts on lines 3 and 4 and enters the smaller amount, $1,300, on line 5.

John enters $48,000 on line 6. This is the taxable income from line 37 of John and Laura's joint return. Sara is an only child, so John enters –0– on line 7. He adds the amounts on line 5 ($1,300), line 6 ($48,000), and line 7 (–0–) and enters the $49,300 total on line 8.

Using the column for married filing jointly in the Tax Table, John finds the tax on $49,300. He enters the tax, $9,593, on line 9. He enters $9,229 on line 10. This is the tax from line 38 of John and Laura's Form 1040. He enters $364 on line 11 ($9,593 – $9,229).

John skips lines 12a and 12b and enters $364 on line 13.

John subtracts the amount on line 5 ($1,300) from the amount on line 4 ($2,300) and enters the result, $1,000, on line 14. Using the column for single filing status in the Tax Table, John finds the tax on $1,000. He enters this tax, $152, on line 15. He adds the amounts on lines 13 ($364) and 15 ($152) and enters the total, $516, on line 16.

Using the column for single filing status in the Tax Table, John finds the tax on $2,300 (the amount on line 4). He enters this tax, $347, on line 17.

John compares the amounts on lines 16 and 17 and enters the larger amount, $516, on line 18 of Sara's Form 8615. He also enters that amount on line 23 of Sara's Form 1040A and checks the box on that line for "Form 8615."

Form **8615**

Department of the Treasury
Internal Revenue Service

Tax for Children Under Age 14 Who Have Investment Income of More Than $1,000

▶ See instructions below and on back.
▶ Attach ONLY to the Child's Form 1040, Form 1040A, or Form 1040NR.

OMB No. 1545-0998

1990

Attachment Sequence No. 33

General Instructions

Purpose of Form. For children under age 14, investment income (such as taxable interest and dividends) over $1,000 is taxed at the parent's rate if the parent's rate is higher than the child's rate.

Do not use this form if the child's investment income is $1,000 or less. Instead, figure the tax in the normal manner on the child's income tax return. For example, if the child had $900 of taxable interest income and $200 of wages, Form 8615 is not required to be completed and the child's tax should be figured on Form 1040A using the Tax Table.

If the child's investment income is more than $1,000, use this form to see if any of the child's investment income is taxed at the parent's rate and, if so, to figure the child's tax. For example, if the child had $1,100 of taxable interest income and $200 of wages, complete Form 8615 and attach it to the child's Form 1040A.

Investment Income. As used on this form, "investment income" includes all taxable income other than earned income as defined on page 2. It includes income such as taxable interest, dividends, capital gains, rents, royalties, etc. It also includes pension and annuity income and income (other than earned income) received as the beneficiary of a trust.

Who Must File. Generally, Form 8615 must be filed for any child who was under age 14 on January 1, 1991, and who had more than $1,000 of investment income. If neither parent was alive on December 31, 1990, do not use Form 8615. Instead, figure the child's tax based on his or her own rate.

Note: *The parent may be able to elect to report the child's investment income on his or her return. If the parent makes this election, the child will not have to file a return or Form 8615. For more details, see the Instructions for Form 1040 or Form 1040A, or get* ***Form 8814****, Parent's Election To Report Child's Interest and Dividends.*

Additional Information. For more information about the tax on investment income of children, please get **Pub. 929**, Tax Rules for Children and Dependents.

(Instructions continue on back.)

Child's name shown on return	Child's social security number
Sara L. Brown	789 00 4351
A Parent's name (first, initial, and last). **(Caution:** See instructions on back before completing.)	**B** Parent's social security number
John J. Brown	459 00 9962

C Parent's filing status (check one):
☐ Single, ☑ Married filing jointly, ☐ Married filing separately, ☐ Head of household, or ☐ Qualifying widow(er)

D Enter number of exemptions claimed on parent's return. (If the parent's filing status is married filing separately, see the instructions.) ▶ 3

Step 1 Figure child's net investment income

1	Enter the child's investment income, such as taxable interest and dividend income (see the instructions). (If this amount is $1,000 or less, stop here; do not file this form.)	1	2,300
2	If the child DID NOT itemize deductions on Schedule A (Form 1040 or Form 1040NR), enter $1,000. If the child ITEMIZED deductions, see the instructions	2	1,000
3	Subtract the amount on line 2 from the amount on line 1. Enter the result. (If zero or less, stop here; do not complete the rest of this form but ATTACH it to the child's return.)	3	1,300
4	Enter the child's **taxable** income (from Form 1040, line 37; Form 1040A, line 22; or Form 1040NR, line 35)	4	2,300
5	Compare the amounts on lines 3 and 4. Enter the **smaller** of the two amounts here ▶	5	1,300

Step 2 Figure tentative tax based on the tax rate of the parent listed above

6	Enter the parent's **taxable** income (from Form 1040, line 37; Form 1040A, line 22; Form 1040EZ, line 5; or Form 1040NR, line 35). But if the parent transferred property to a trust, see the instructions	6	48,000
7	Enter the total, if any, of the net investment income from Forms 8615, line 5, of ALL OTHER children of the parent. (Do not include the amount on line 5 above.)	7	0
8	Add the amounts on lines 5, 6, and 7. Enter the total	8	49,300
9	Tax on the amount on line 8 based on the **parent's** filing status	9	9,593
10	Enter the parent's tax (from Form 1040, line 38; Form 1040A, line 23; Form 1040EZ, line 7; or Form 1040NR, line 36)	10	9,229
11	Subtract the amount on line 10 from the amount on line 9. Enter the result. (If no amount is entered on line 7, enter the amount from line 11 on line 13; skip lines 12a and 12b.)	11	364
12a	Add the amounts on lines 5 and 7. Enter the total (12a)		
b	Divide the amount on line 5 by the amount on line 12a. Enter the result as a decimal (rounded to two places)	12b	x .
13	Multiply the amount on line 11 by the decimal amount on line 12b. Enter the result ▶	13	364

Step 3 Figure child's tax

Note: *If the amounts on lines 4 and 5 are the same, skip to line 16.*

14	Subtract the amount on line 5 from the amount on line 4. Enter the result	14	1,000		
15	Tax on the amount on line 14 based on the **child's** filing status			15	152
16	Add the amounts on lines 13 and 15. Enter the total			16	516
17	Tax on the amount on line 4 based on the **child's** filing status			17	347
18	Compare the amounts on lines 16 and 17. Enter the **larger** of the two amounts here and on Form 1040, line 38; Form 1040A, line 23; or Form 1040NR, line 36. Be sure to check the box for "Form 8615" ▶			18	516

33. Child and Dependent Care Credit

If you pay someone to care for your dependent under 13, or your disabled spouse or dependent, you may be able to get a credit of up to 30% of your expenses. To qualify, you must pay these expenses so you can work or look for work.

If you can take the child and dependent care credit, you may want to claim more withholding allowances to have less income tax withheld from your pay. See Chapter 5 for additional information.

You may have to pay employment taxes. If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer who has to pay employment taxes. Usually, you are *not* a household employer if the person who cares for your child or dependent does so at his or her home or place of business. See *Employment Taxes for Household Employers*, later, for a discussion of how to figure employment taxes and what forms you must file if you are a household employer. For more information, see Publication 926, *Employment Taxes for Household Employers.*

General Requirements

The chart on this page shows the general requirements for claiming a credit for child and dependent care expenses.

Qualifying Persons

Your child and dependent care expenses must be for the care of one or more members of your home who are qualifying persons. A qualifying person is:

1) Your dependent under 13 for whom you can claim an exemption (also see *Child of Divorced or Separated Parents*, later),
2) Your spouse who is physically or mentally not able to care for himself or herself, or
3) Your dependent who is physically or mentally not able to care for himself or herself, even if you cannot claim an exemption for the person.

Physically or mentally not able to care for oneself. Persons who are not able to dress, clean, or feed themselves because of physical or mental problems are considered not capable of self-care. Also, persons who require constant attention to prevent them from injuring themselves or others are considered not capable of self-care.

Qualification determined daily. You determine a person's qualifying status each day when the person qualifies for less than a full calendar month. For example, if the person you pay child and dependent care expenses for no longer qualifies on September 16, count only those expenses through September 15. Also see *Dollar Limit*, later.

Child of Divorced or Separated Parents

If you are divorced or separated (defined later), your child is a qualifying person if you are the custodial parent and your child:

1) Is under 13 or is not capable of self-care,
2) Is in the custody of one or both parents for more than half of the year, and
3) Receives more than half of his or her support from one or both parents.

You are the custodial parent if, during the year, you have custody of your child longer than your child's other parent has custody.

You generally must claim an exemption for a child under the age of 13. However, you can treat the child as a qualifying person if you meet all the other requirements but do not claim the exemption because:

1) The noncustodial parent claims the exemption because you signed Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, or similar statement, or
2) The noncustodial parent provides at least $600 for the support of the child and claims the exemption under a qualified pre-1985 decree of divorce or separate maintenance, or a written separation agreement.

If you can take the credit because of this exception, write your child's name in the space to the left of line 3, Form 2441 or Schedule 2 (Form 1040A).

The noncustodial parent cannot treat the child as a qualifying person, even if that parent can claim an exemption for the child.

Example. You are divorced and have custody of your 8-year-old child. You sign Form 8332 to allow your ex-spouse to take the exemption. You pay child care expenses so you can work. Your child is a qualifying person and you, the custodial parent, can claim the credit for those expenses, even though your ex-spouse claims an exemption for the child.

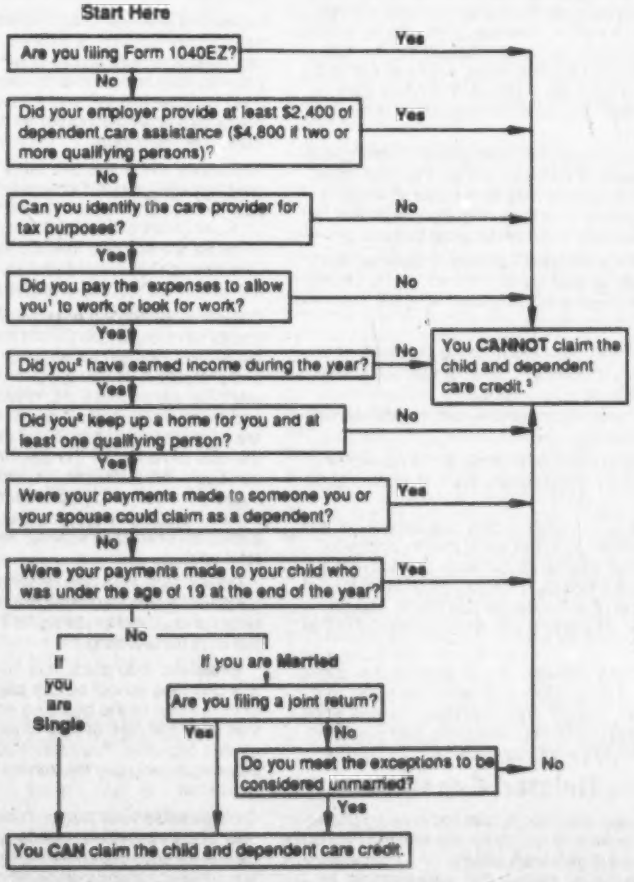
Divorced or separated. You are considered divorced or separated if either of the following apply.

1) You are divorced or separated under a decree of divorce or separate maintenance or a written separation agreement.
2) You lived apart from your spouse for all of the last 6 months of the year.

Keeping Up a Home

You are keeping up a home if you (and your spouse if you are married) pay more than half

General Requirements Chart


Start Here
Are you filing Form 1040EZ?
Yes
No
Did your employer provide at least $2,400 of dependent care assistance ($4,800 if two or more qualifying persons)?
Yes
No
Can you identify the care provider for tax purposes?
No
Yes
Did you pay the expenses to allow you[1] to work or look for work?
No
Yes
Did you[2] have earned income during the year?
No
You CANNOT claim the child and dependent care credit.[3]
Yes
Did you[2] keep up a home for you and at least one qualifying person?
No
Yes
Were your payments made to someone you or your spouse could claim as a dependent?
Yes
No
Were your payments made to your child who was under the age of 19 at the end of the year?
Yes
No
If you are Single
If you are Married
Are you filing a joint return?
Yes
No
Do you meet the exceptions to be considered unmarried?
No
Yes
You CAN claim the child and dependent care credit.

[1] This also applies to your spouse, unless your spouse was disabled or a full time student.
[2] You and your spouse if you were married.
[3] If you had expenses that met the requirements for 1989, except that you did not pay them until 1990, you may be able to claim those expenses in 1990. See *Expenses not paid until the following year*, later.

the cost of running it for the year. Home means the main home for both you and the qualifying person. Your home can be the main home even if the qualifying person does not live there all year because of his or her:

Birth,

Death, or

Temporary absence due to:

a) Sickness,

b) School,

c) Business,

d) Vacation,

e) Military service, or

f) Custody agreement.

Upkeep expenses normally include property taxes, mortgage interest, rent, utility charges, home repairs, insurance on the home, and food eaten at home.

Upkeep expenses do not include payments for clothing, education, medical treatment, vacations, life insurance, transportation, and mortgage principal. They also do not include the purchase, permanent improvement, or replacement of property. For example, the cost of replacing a water heater is not considered upkeep, but the cost of repairing a water heater can be included.

Work Requirement

Your work can be for others or in your own business or partnership. It can be either full time or part time. Work also includes actively looking for work. However, if you do not find a job and have no earned income for the year, you cannot take this credit. Also see *Earned Income Limit*, later. Unpaid volunteer work or volunteer work for a nominal salary does not qualify.

If you are married, both you and your spouse must work. If you work but your spouse does not, your spouse may be treated as working and earning income during any month that he or she meets the rule discussed next.

Rule for a student-spouse or spouse not capable of self-care. Your spouse is treated as working and earning income if, for any month, he or she is:

1) A full-time student during at least some part of each of 5 months during the tax year, or
2) Physically or mentally not capable of self-care.

Figure the earned income of the nonworking spouse as shown under *Earned Income Limit*, later.

This rule applies to only one spouse for any one month. If, in the same month, both you and your spouse do not work and are either full-time students or physically or mentally not capable of self-care, neither of you can be treated as working and earning income in that month.

Surviving spouse. If your spouse died during 1990 and you file a joint return as a surviving spouse, you are not considered married when claiming this credit. Therefore, only you need to meet the work requirement.

Work-Related Expenses

Child and dependent care expenses must be work related to qualify for the credit. Expenses are considered work related only if they allow you (and your spouse if you are married) to work. Whether you had the expenses to allow you to work depends on the facts. Expenses are not considered work related merely because you had them while you were working.

The care provided must be for a qualifying person's well-being and protection. Expenses for household services qualify if part of the services are for the care of qualifying persons. You do not have to choose the least expensive manner of providing the care. For details, see *Care of a qualifying person* and *Household services*, later.

If you are married, generally both you and your spouse must work. In certain cases, however, your spouse does not have to work. See *Rule for a student-spouse or spouse not capable of self-care*, earlier.

Work-related expenses determined daily. If you work, or actively look for work, during only part of the period covered by the expenses, then you must figure your expenses for each day. For example, if you work all year and pay care expenses of $120 a month ($1,440 for the year), all the expenses are work related. However, if you work or look for work for only 2 months and 15 days during the year, your work-related expenses are limited to $300 (2½ months × $120).

Expenses not paid until the following year. You can count only the expenses that you pay during the year you are taking the credit. In other words, if you had expenses in 1989 that you did not pay until 1990, you cannot count them when figuring your credit for 1989. However, you may be able to claim a credit for all or part of them on your 1990 tax return. You must file Form 1040, not Form 1040A, to claim a credit for expenses you had in the preceding year. See Publication 503 for an example.

Expenses prepaid in an earlier year. If you pay for services before they are provided, you can count the prepaid expenses only in the year the care is received. Fill out your Form 2441 or Schedule 2 (Form 1040A) for the later year as if the prepaid expense was actually paid in the later year.

Payments while you are out sick. Do not count as work-related expenses amounts you pay for child and dependent care while you are off from work because of illness. These amounts are not paid to allow you to work. This rule applies even if you get sick pay and are still considered an employee.

Care of a qualifying person. The main reason to have expenses for the care of a qualifying person must be for the person's well-being and protection. These expenses do not include amounts you pay for food, clothing, schooling, and entertainment. However, if these amounts are incident to and cannot be separated from the cost of caring for the qualifying person, you can count the total cost. For example, if a nursery school or day-care center provides lunch and educational activities as a part of its preschool child care service, you can count the total cost.

Do not count the cost of schooling in the first grade or higher. You must divide the total cost between the cost of caring for the child and the cost of schooling.

Example. You place your 10-year-old child in a boarding school so you can work full time. Only the part of the boarding school expense that is for the care of your child is a work-related expense. You cannot count any part of the amount you pay the school for your child's education.

Care outside your home. You can count the cost of care provided outside your home if the care is for your dependent under age 13, or any other qualifying person who regularly spends at least 8 hours each day in your household. Care that is provided outside your home by a dependent care center can be counted if the center complies with all applicable state and local regulations.

Dependent care center. A dependent care center is a place that provides care for more than six persons (other than persons who live there) and receives a fee, payment, or grant for providing services for any of those persons, even if the center is not run for profit.

The cost of sending your child to an overnight camp is ***not*** considered a work-related expense.

Transportation. The cost of getting a qualifying person to and from your home and the care location is ***not*** considered a work-related expense. This includes the costs of bus, subway, taxi, or private car. Also, if you pay the transportation cost for the care provider to come to your home, you cannot count this cost as a work-related expense.

Household services. All of your necessary expenses for household services are work related even if they were only ***partly*** for the well-being and protection of a qualifying person. Ordinary services done in and around your home that are necessary to run your home are counted as household services. The services of a housekeeper, maid, or cook are usually considered necessary to run your home if they are done at least partly for the benefit of the qualifying person. However, the services of a chauffeur or gardener are not considered necessary.

If part of an expense is work related (for either household services or the care of a qualifying person) and part is for other purposes, you have to allocate the expense. Count only the part that is work related. However, you do not have to allocate the expense if only a small part is for the other purposes.

Example. You pay a housekeeper to care for your 9-year-old and 15-year-old children so you can work. The housekeeper spends most of the time doing normal household work and spends 30 minutes a day driving you to and from work. The entire expense of the housekeeper is a work-related expense. You do not have to deduct any amount for being driven to and from work because the time involved is minimal. You do not have to deduct any amount for the care of the 15-year-old child (not a qualifying person) because the household expense is partly for the care of the 9-year-old child, who is a qualifying person.

Meals and lodging provided for housekeeper. If you have expenses for food that your housekeeper eats in your home, count these as work-related expenses. If you have extra expenses for your housekeeper's lodging, count these as work-related expenses. For example, if you moved to an apartment with an extra bedroom for the housekeeper, count the extra rent and utility expenses for this bedroom as work-related expenses. Or, if your housekeeper moves into an existing bedroom in your home, count the extra utility expenses you may have as work-related expenses.

Do not include the value of meals provided for your own convenience as wages on the Form W–2, *Wage and Tax Statement*, you give your housekeeper. Do not include the value of lodging if you provide it for your convenience and require the housekeeper to live in your home.

Taxes paid on wages. If you pay wages for household help, you may have to pay the employer's portion and withhold the employee's portion of the social security tax (FICA). You may also have to pay federal unemployment tax (FUTA) and similar state taxes. See *Employment Taxes for Household Employers*, later. The taxes you pay on wages for qualifying child and dependent care services are work-related expenses.

Special rules. Depending on the facts, certain other work-related expenses may or may not qualify for the credit.

Medical expenses. Some expenses for the care of a qualifying person who is not capable of self-care may qualify as work-related expenses and also as medical expenses. You can use them either way, but you cannot use the same expenses to claim both a credit and a medical expense deduction. If you use these expenses to figure the credit and they are more than the earned income limit or the dollar limit, discussed later, you can add the excess to your medical expenses. However, if you use your total cost to figure your medical expense deduction, you cannot use any part of them to figure your credit.

Note. Any amount that is excluded from your income under your employer's dependent care assistance plan ***cannot*** be used to claim a medical expense deduction.

Payments to relatives. You can count work-related payments you pay to relatives who are not your dependents, even if they live in your home. However, do not count any amounts you pay to:

1) A dependent for whom you (or your spouse if you are married) can claim an exemption, or
2) Your child who was under the age of 19 at the end of the year, even if he or she is not your dependent.

Marital Status

Generally, married couples must file a joint return to take the credit. However, if you are legally separated or living apart from your spouse, you may be able to file separate returns and still take the credit.

Married couple. If you are married at the end of your tax year, you must file a joint return with your spouse to take the credit.

Legally separated. You are not considered married if you are legally separated from your spouse under a decree of divorce or separate maintenance. You are eligible to take the credit on a separate return.

Married and living apart. You are not considered married and are eligible to take the credit if **all** the following apply:

1) You file a separate return.
2) Your home is the home of a qualifying person for more than half the year.
3) You pay more than half the cost of keeping up your home for the year.
4) Your spouse does not live in your home for the last 6 months of the year.

Provider Identification

You must identify all persons or organizations that provide care for your child or dependent. Do this on the same form you use to claim the credit. If you file Form 1040, use Part I of Form 2441, *Child and Dependent Care Expenses*, to report the required information. If you file Form 1040A, use Part I of Schedule 2.

Information required. To identify the care provider, you must give the provider's:

1) Name,
2) Address, and
3) Taxpayer identification number.

If the care provider is an individual, the taxpayer identification number is often the social security number. If the care provider is an organization, then it is the employer identification number (EIN). The taxpayer identification number is not required if the care provider is one of certain tax-exempt organizations (such as a church or school). In this case write "Tax-Exempt" in the space where the tax form calls for the number.

If you cannot provide all of the information required, or if the information is incorrect, you must be able to show that you used due diligence (discussed later) in trying to furnish the required information.

Getting the information. You can use **Form W–10**, *Dependent Care Provider's Identification and Certification*, to request the required information from the care provider. If you do not use Form W–10, you can get the required information from any of the following:

1) A copy of the provider's social security card,
2) A copy of the provider's driver's license (in a state where the license includes the social security number),
3) A copy of the provider's completed Form W–4 if he or she is your household employee,
4) A copy of the statement furnished by your employer if the provider is your employer's dependent care assistance program, or
5) A letter or invoice from the provider if it shows the required information.

You should keep the required information about the care provider with your tax records. Do not send Form W–10 (or other document if Form W–10 is not used) to the Internal Revenue Service.

Due diligence. If the care provider information you give is incorrect or incomplete, your credit may not be allowed. However, if you can show that you used due diligence in trying to supply the required information, you can still claim the credit.

You can show due diligence by getting and keeping the provider's completed Form W–10 or one of the other sources of information listed above. Care providers can be penalized if they do not provide this information to you or if they provide incorrect information.

Provider refusal. If the provider refuses to give you the required information, you should report whatever information you have (such as the name and address) on the form you use to claim the credit. Write "See attached" in the column calling for the information you do not have and attach a statement to your return explaining the situation. This statement will show that you used due diligence in trying to furnish the required information.

How to Figure the Credit

Your credit is a percentage of your work-related expenses. First, you must figure both the earned income limit and the dollar limit on those expenses. Then, depending on how much adjusted gross income you have, you figure the applicable percentage for the credit.

Earned Income Limit

The amount of work-related expenses you use to figure your credit cannot be more than:

1) Your earned income for the year, if you are *single* at the end of the year, or
2) The smaller of your earned income or your spouse's earned income for the year, if you are *married* at the end of the year.

If you remarried during the year, use the earned income of the spouse you are married to at the end of the year.

Earned income includes wages, salaries, tips, other employee compensation, and net earnings from self-employment. Earned income also includes strike benefits and any disability pay you report as wages (see Chapter 11). You should disregard community property laws when you figure your earned income for this credit.

Self-employment. If you are self-employed, you must include your net earnings in earned income. For purposes of the child and dependent care credit, net earnings from self-employment means the amount from line 3 of Schedule SE ***minus*** any deduction on line 25 of Form 1040 ***plus*** any self-employment earnings not reported on Schedule SE because they are less than $400. Subtract any business losses from your earned income. If you filed Schedule C to report income as a statutory employee, also include as earned income the amount from line 29 of that Schedule C. You can figure your net earnings from your business either by the regular method or the optional method. If you can use the optional method to figure self-employment tax, you may be able to increase your earned income for this credit. Get Publication 533, *Self-Employment Tax*, for details. In this case, subtract any deduction you claimed on Form 1040, line 25, from the total of the amounts on Schedule SE, Section B, lines 3 and 4b, to figure earned income.

Income exempt from self-employment tax as a result of the filing and approval of Form 4361 (generally relating to the clergy) is earned income if it is wages, salaries, tips, or other employee compensation. This includes a housing allowance or the rental value of a parsonage that you get as part of your pay for services as an employee.

Income exempt from self-employment tax as a result of the filing and approval of Form 4029 (relating to members of certain religious faiths) is ***not*** earned income.

Earned income does not include pensions or annuities, social security payments, workers' compensation, interest, dividends, or unemployment compensation.

Student-spouse or spouse not capable of self-care. As discussed earlier under *Work Requirement*, a spouse that is either a full-time student or not capable of self-care is treated as working and earning income. The earned income of such a spouse for each month is considered to be $200 if there is one qualifying person in your home, or $400 if there are two or more. However, if your spouse does work during that month, use the higher of $200 (or $400) or his or her actual earned income for that month. If your spouse is a full-time student (or not capable of self-care) for only part of a month, the full $200 (or $400) still applies. Full-time student is defined in Chapter 3. Only one spouse can be considered to have this earned income of $200, or $400, for any one month. If, in the same month, both you and your spouse do not work and are either full-time students or not capable of self-care, you cannot use any amount you pay that month to figure the credit, even if you are looking for work.

Surviving spouse. If your spouse died during 1990 and you file a joint return as a surviving spouse, you are not considered married for purposes of the credit. Consider only your income in figuring the earned income limit.

Dollar Limit

There is a dollar limit on the amount of your work-related expenses you can use to figure the credit. This limit is $2,400 for one qualifying person, or $4,800 for two or more qualifying persons.

Yearly limit. The dollar limit is a yearly limit. The amount of the limit remains the same no matter how long you have a qualifying person in your household. In other words, use the

$4,800 limit if you had more than one qualifying person at any time during the year.

Total work-related expenses. When you figure your total work-related expenses for the year, count only the ones you had for a qualifying person during the time the person qualified. For example, your son is your only qualifying person. If he turns 13 in 1990, you can count only the expenses you had before your son's thirteenth birthday. If you had expenses of less than $2,400 during the time your son qualified, count only the smaller amount.

Reduced Dollar Limit

Your employer may provide you with child and dependent care benefits. The dollar limit is reduced by these benefits when you figure the credit.

Employer-provided dependent care assistance plan. You must subtract from the dollar limit any benefit you receive that is excluded from your income under an employer-provided dependent care assistance plan. The value of this benefit is excludable if the plan meets certain requirements. Your employer can tell you whether the plan qualifies. If it does, the excludable amount is limited to the smaller of:

1) Your earned income,
2) Your spouse's earned income, or
3) $5,000 ($2,500 if married filing separately).

You must subtract this excludable amount from the dollar limit ($2,400 or $4,800, whichever applies) to get the reduced limit on the amount of work-related expenses you can use to figure the credit.

Statement for employee. Your employer must give you a Form W–2, *Wage and Tax Statement* (or similar statement), showing the total amount of dependent care assistance benefits provided to you during the year.

Example. You are a widower with one child and earn $20,000 a year at work. You pay work-related expenses of $1,600 for your 4-year-old child and qualify to claim the credit for child and dependent care expenses. Your employer pays an additional $1,000 under an employer-provided dependent care assistance plan. This $1,000 is excluded from your income. The dollar limit for your work-related expenses is $2,400 (one qualifying person). However, your credit is figured on only $1,400 of the $1,600 work-related expenses you paid because the dollar limit is reduced to $1,400 by the excludable benefits as follows:

Dollar limit: Maximum allowable expenses for one qualifying person	$2,400
Minus: Employer-provided dependent care benefits you can exclude from income	1,000
Reduced limit on expenses you can use for the credit	$1,400

Forfeitures. Forfeitures are amounts credited to your dependent care assistance account but which you no longer have a right to receive as reimbursements. You must subtract any forfeitures from the total employer-provided dependent care benefits reported by your employer. Forfeitures do not include amounts that you expect to receive for dependent care assistance incurred during the year that has not yet been reimbursed but may be claimed in the future.

Amount of Credit

To determine the amount of your credit, multiply your work-related expenses (after applying the earned income and dollar limits) by the applicable percentage. The percentage depends on your adjusted gross income. The following shows the applicable percentage based on adjusted gross income.

Adjusted Gross Income			Applicable Percentage
Over		But not over	
$ 0	—	$10,000	30%
10,000	—	12,000	29%
12,000	—	14,000	28%
14,000	—	16,000	27%
16,000	—	18,000	26%
18,000	—	20,000	25%
20,000	—	22,000	24%
22,000	—	24,000	23%
24,000	—	26,000	22%
26,000	—	28,000	21%
28,000	—	No Limit	20%

Alternative minimum tax limit. Your credit may be limited because of the alternative minimum tax. If you file Schedules C, D, E, or F (Form 1040), you should complete Form 6251, *Alternative Minimum Tax—Individuals*, to figure whether your credit will be limited. If you did not file those schedules, you should complete the worksheet that comes with the instructions for line 16, Form 2441, to see if you still need to complete Form 6251.

How to Claim the Credit

To claim the credit, you can file Form 1040 or Form 1040A. You cannot claim the credit on Form 1040EZ. You must file a joint return if you are married, unless the exceptions discussed earlier under *Marital Status* apply to you.

Form 1040. You must complete **Form 2441,** *Child and Dependent Care Expenses*, and attach it to your Form 1040.

Form 1040A. You must complete **Schedule 2** (Form 1040A), *Child and Dependent Care Expenses for Form 1040A Filers*, and attach it to your Form 1040A. See Chapter 37 for an example and a filled-in Schedule 2.

Tax credit not refundable. Your credit for child and dependent care expenses cannot be more than the amount of your tax liability. Therefore, you cannot get a refund for any part of the credit that is over that amount.

Records. You should keep records of your work-related expenses. Also, if your dependent or spouse is not capable of self-care, your records should show both the nature and the length of the disability. Other records you should keep to support your claim for the credit are described earlier under *Provider Identification.*

Examples

The following examples show how to figure the credit. Example 2 is illustrated by the filled-in Form 2441 at the end of this chapter.

Example 1: Child Care—Two Children. Ann Jones is a widow and keeps up a home for herself and her two preschool children. She claims her children as dependents and files Form 1040A. Her adjusted gross income is $20,000 and the entire amount is earned income.

During the year Ann pays work-related expenses of $3,000 for child care at a neighbor's home and $2,200 for child care at Pine Street Nursery School.

Ann figures her credit as follows.

Child care by neighbor	$3,000
Child care by nursery school	2,200
Total work-related expenses	$5,200
Maximum allowable expenses for two qualifying persons	$4,800
Amount of credit (25% of $4,800)	$1,200

Because Ann's earned income is at least $4,800, the earned income limit, discussed earlier, does not apply.

Example 2: Employer-Provided Benefits. Joan Thomas is divorced and has two children, ages 3 and 9. She works at ACME Computers. Her adjusted gross income is $29,000 and the entire amount is earned income.

Joan's younger child stays at her employer's on-site child care center while she works. The benefits from this child care center qualify to be excluded from her income. Her employer reports the value of this service to her as $3,000 for the year. This $3,000 is shown on her Form W–2, but is not reported as taxable income.

A neighbor cares for Joan's older child after school, on holidays, and during the summer. She pays her neighbor $2,400 for this care.

Joan figures her credit as follows.

1) Work-related expenses Joan paid	$2,400
2) Dollar limit: Maximum allowable expenses for two or more qualifying persons	$4,800
3) Minus: Employer-provided dependent care benefits excluded from income	3,000
4) Reduced limit on expenses Joan can use for the credit	$1,800
5) **Amount of credit (20% of the lesser of lines 1 or 4)**	$ 360

Note. Even though the total of the expenses paid by Joan ($2,400) was less than the dollar limit for two or more qualifying persons ($4,800), it is the dollar limit, discussed earlier, that is reduced by the excludable amount.

This example, using Form 2441 (Form 1040), is illustrated later. The illustration shows how to claim the child and dependent care credit, how to exclude the employer-provided dependent care benefits, and how to report the identification of the care provider.

Employment Taxes for Household Employers

Generally, if you pay someone to work in your home, such as a babysitter, that person is your household employee. If you have a household employee you may be subject to:

1) Social security tax,
2) Federal unemployment tax, and
3) Federal income tax withholding.

Social security tax (FICA) is withheld from the employee's pay and matched by the employer. Federal unemployment tax (FUTA) is paid by the employer only and is for the employee's unemployment insurance. Federal income tax is withheld from the employee's total pay if the employee asks you to do so and you agree.

If you use a placement agency to get a babysitter or companion who works in your home, that person is not your employee if the agency sets the fee and exercises control over the sitter. This control could include providing rules of conduct and appearance and requiring regular reports. In this case, you do not have to pay employment taxes. But, if an association merely gives you a list of sitters and you hire

one from that list, the sitter may be your employee.

Social Security (FICA) Tax

If you pay a household employee cash wages of $50 or more during a calendar quarter, those wages are subject to social security tax. Payments in kind (meals, transportation, etc.) are not used to figure the $50 amount or to figure the tax. The tax is figured on all cash wage payments in the quarter, regardless of when they were earned.

Both you and the employee pay a share of the social security tax on the employee's wages. For 1990 and 1991 the social security tax rate for each of you is 7.65%. Therefore, in 1990 you should have deducted 7.65% from each cash wage payment you made during a calendar quarter, if you paid the employee $50 or more during the quarter. The combined rate for you and the employee was 15.3% (7.65% plus 7.65%). The tax applied to the first $51,300 you paid each employee during calendar year 1990.

You must pay the total tax yourself if you do not deduct the employee's share from his or her wages. Any of the employee's share you pay is added income to the employee. This income must be included in box 10, *Wages, tips, other compensation*, on Form W–2, *Wage and Tax Statement*, but do not count it as cash wages for social security purposes. You must also include the employee social security tax you pay in box 11 of the employee's Form W–2, even though the tax was not actually withheld.

You report and pay the social security tax quarterly on Form 942, *Employer's Quarterly Tax Return for Household Employees*. The form has instructions for filling it out and a table to determine how much to deduct from the employee's wages.

Income Tax Withholding

If your household employee requests income tax withholding, and you agree, you must withhold an amount from each payment based on the information shown on the **Form W–4**, *Employee's Withholding Allowance Certificate*, given to you by the employee. Publication 15, *Circular E, Employer's Tax Guide*, explains how to figure the amount to withhold.

Earned income credit advance payment. You must make advance payments of the earned income credit to any eligible employee who requests it. Employees who earn under $20,264 in 1990 ($21,246 in 1991) and meet certain other conditions are eligible. The employee makes the request by giving you a completed **Form W–5**, *Earned Income Credit Advance Payment Certificate*. Each payday, you make the payments to your employee from the social security taxes and withheld income taxes that you would otherwise pay to the Internal Revenue Service. For more information, see Publication 15.

You must notify any employees not having federal income tax withheld that they may be eligible for an income tax refund because of the earned income credit. For more information, see the instructions for Form 942.

Caution. As this publication was being prepared for print, Congress was considering changes in the tax law that would increase the earned income credit for 1991. The changes could also increase your responsibilities as an employer. For additional information on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes*.

Filing Form 942. You must report on Form 942 the taxes withheld each quarter if:

1) You are liable for social security tax, or
2) Your employee asked you to withhold federal income tax and you agreed.

If you own a business as a sole proprietor, you can include your household employee on Form 941, *Employer's Quarterly Federal Tax Return*. Do ***not*** include your household employees on a Form 941 filed for a partnership or corporation.

When to file. File starting with the first quarter in which you:

1) Pay wages subject to social security tax, or
2) Withhold income tax as requested by your employee.

Due Dates for Returns

Quarter	Ending	Due Date
Jan.-Feb.-Mar.	Mar. 31	Apr. 30
Apr.-May-June	June 30	July 31
July-Aug.-Sept.	Sept. 30	Oct. 31
Oct.-Nov.-Dec.	Dec. 31	Jan. 31

If the due date for filing a return falls on a Saturday, Sunday, or a legal holiday, you can file the return on the first day afterward that is not a Saturday, Sunday, or legal holiday.

For more information about employment taxes for household employers, see Publication 926, *Employment Taxes for Household Employers*, and the instructions for Form 942.

Federal Unemployment Tax (FUTA)

Federal unemployment tax is for your employee's unemployment insurance. If you paid cash wages of $1,000 or more to household employees in any calendar quarter this year or last year, you are liable for FUTA tax for any employees you have this year. However, FUTA does not apply to wages paid to your spouse, to your parents, or to your children under 21 years old.

Rate. The rate is 6.2% on the first $7,000 of cash wages paid to each employee during the calendar year.

The FUTA tax is imposed on you as the employer. You must not collect or deduct it from the wages of your employees.

You can take a credit against your federal unemployment tax for the unemployment tax you pay to the state. Your net federal tax may be as low as 0.8% if you pay the state tax on time.

See Publication 553, *Highlights of 1990 Tax Changes*, for the 1991 tax rate.

When you hire a household employee, you should contact your state employment tax office to get information on how to file the state return and to get a state reporting number. The state will give you your experience rate, which you use to figure the amount of tax you will pay the state.

You must file an annual return on Form 940–EZ or Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, by January 31 following the close of the calendar year for which the tax is due. Form 940–EZ is a less complicated version of Form 940 and can be used by most household employers if:

1) You paid state unemployment tax to only one state,
2) You paid all your state unemployment tax by the due date of Form 940–EZ, and
3) Your Federal unemployment (FUTA) wages were also taxable for your state's unemployment tax.

If you do not meet these requirements, you must use Form 940 to report your federal unemployment taxes. Any tax still due must be paid with the return.

After you have filed your first return, the IRS will mail Form 940–EZ or Form 940 to you. However, if you do not receive it, get one in time to file.

For more information, see Publication 926 and the instructions to Form 940–EZ or Form 940.

Form **2441**

Department of the Treasury
Internal Revenue Service

Child and Dependent Care Expenses

▶ Attach to Form 1040.
▶ See separate Instructions.

OMB No. 1545-0068

1990

Attachment Sequence No. 21

Name(s) shown on Form 1040: Joan Thomas

Your social security number: 135 00 2468

- If you are claiming the child and dependent care credit, complete Parts I and II below. But if you received employer-provided dependent care benefits, first complete Part III on the back.
- If you are not claiming the credit but you received employer-provided dependent care benefits, only complete Part I, below, and Part III on the back.

Part I **Persons or Organizations Who Provided the Care—You must complete this part.** (See the Instructions. If you need more space, attach a statement.)

1 (a) Name	(b) Address (number, street, city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see Instructions)
Sue Harris	123 Main Street Hometown, MI 48002	421-00-1111	2,400
ACME Computers	See W-2		

2 Add the amounts in column (d) of line 1 and enter the total 2 2,400

Note: *If you paid cash wages of $50 or more in a calendar quarter to an individual for services performed in your home, you must file an employment tax return. Get Form 942 for details.*

Part II **Credit for Child and Dependent Care Expenses**

3 Enter the number of qualifying persons who were cared for in 1990. (See the Instructions for the definition of qualifying persons.) **Caution:** *To qualify, the person(s) must have shared the same home with you in 1990* . . . ▶ 3 2

4 Enter the amount of **qualified** expenses you incurred and actually paid in 1990. See the Instructions to find out which expenses qualify. **Caution:** *If you completed Part III on page 2, do not include on this line any excluded benefits shown on line 25* 4 2,400

5 Enter $2,400 ($4,800 if you paid for the care of two or more qualifying persons) 5 4,800

6 If you completed Part III on page 2, enter the **excluded benefits,** if any, from line 25 . . . . . 6 3,000

7 Subtract line 6 from line 5 and enter the result. (If the result is zero or less, skip lines 8 through 13. Enter zero on line 14, and go to line 15.) 7 1,800

8 Compare the amounts on lines 4 and 7. Enter the **smaller** of the two amounts here 8 1,800

9 You **must** enter your **earned income.** (See the Instructions for the definition of earned income.) . . 9 29,000

10 If you are married filing a joint return, you **must** enter your spouse's earned income. (If your spouse was a full-time student or disabled, see the Instructions for the amount to enter.). 10

11 If you are married filing a joint return, compare the amounts on lines 9 and 10. Enter the **smaller** of the two amounts here 11

12 • If you are married filing a joint return, compare the amounts on lines 8 and 11. Enter the **smaller** of the two amounts here.
• All others, compare the amounts on lines 8 and 9. Enter the **smaller** of the two amounts here. 12 1,800

13 Enter the decimal amount from the table below that applies to the **adjusted gross income** on Form 1040, line 32 . . . . . 13 x .20

If line 32 is: Over—	But not over—	Decimal amount is:	If line 32 is: Over—	But not over—	Decimal amount is:
$0	10,000	.30	$20,000	22,000	.24
10,000	12,000	.29	22,000	24,000	.23
12,000	14,000	.28	24,000	26,000	.22
14,000	16,000	.27	26,000	28,000	.21
16,000	18,000	.26	28,000		.20
18,000	20,000	.25			

14 Multiply the amount on line 12 by the decimal amount on line 13 and enter the result 14 360

15 Multiply any child and dependent care expenses for 1989 that you paid in 1990 by the decimal amount that applies to the adjusted gross income on your 1989 Form 1040, line 32, or Form 1040A, line 14. Enter the result. (You must complete Part I and attach a statement. See the Instructions.) . . 15

16 Add the amounts on lines 14 and 15. See the Instructions for the amount of credit you can claim . . 16 360

For Paperwork Reduction Act Notice, see separate Instructions. Form 2441 (1990)

Part III **Employer-Provided Dependent Care Benefits**—Complete this part only if you received employer-provided dependent care benefits. Also, be sure to complete Part I.

17	Enter the total amount of employer-provided dependent care benefits you received for 1990. (This amount should be shown in Box 15 of your W-2 form(s).) Do **not** include amounts that were reported to you as wages in Box 10 of Form(s) W-2	17	3,000
18	Enter the amount forfeited, if any. **Caution:** *See the Instructions.*	18	-0-
19	Subtract line 18 from line 17 and enter the result	19	3,000
20	Enter the total amount of qualified expenses incurred in 1990 for the care of a qualifying person. (See the Instructions.)	20	5,400
21	Compare the amounts on lines 19 and 20. Enter the **smaller** of the two amounts here	21	3,000
22	You **must** enter your **earned income**. (See the Instructions for lines 9 and 10 for the definition of earned income.)	22	29,000
23	If you were married at the end of 1990, you **must** enter your spouse's earned income. (If your spouse was a full-time student or disabled, see the Instructions for lines 9 and 10 for the amount to enter.)	23	
24	• If you were married at the end of 1990, compare the amounts on lines 22 and 23. Enter the **smaller** of the two amounts here. • If you were unmarried, enter the amount from line 22 here.	24	29,000
25	**Excluded benefits.** Enter here the **smallest** of the following: • The amount from line 21, or • The amount from line 24, or • $5,000 ($2,500 if married filing a separate return).	25	3,000
26	**Taxable benefits.** Subtract line 25 from line 19. Enter the result, but not less than zero. Also include this amount in the total on Form 1040, line 7. On the dotted line next to line 7, write "DCB"	26	-0-

Note: *If you are also claiming the child and dependent care credit, fill in Form 1040 through line 40. Then complete Part II of this form.*

34. Credit for the Elderly or the Disabled

This chapter explains who qualifies for the credit for the elderly or the disabled and how to figure this credit. The maximum credit available is $1,125. You may claim this credit if you are age 65 or older, or if you retired on disability and were permanently and totally disabled when you retired.

You can claim the credit if you file Form 1040 or 1040A. You cannot claim the credit if you use Form 1040EZ. You figure the credit on Schedule R (Form 1040), or on Schedule 3 Form 1040A, *Credit for the Elderly or the Disabled.*

The Internal Revenue Service will figure your credit. If you choose to have the IRS figure your tax on Form 1040 or Form 1040A, and you qualify for the credit for the elderly or the disabled, the Service will figure the credit for you. See *Tax Figured by IRS* in Chapter 31.

Can You Take the Credit?

You can take the credit for the elderly or the disabled if you are a qualified individual.

Qualified Individual

You are a qualified individual for this credit if you are a U.S. citizen or resident and:

1) You are age 65 or older by the end of the tax year, or
2) You are under age 65 at the end of the tax year, and
   a) You are retired on permanent and total disability,
   b) You did not reach mandatory retirement age before 1990, and
   c) You received taxable disability benefits in 1990.

Age 65. You are considered 65 on the day before your 65th birthday. Therefore, you are 65 by the end of 1990 if your 65th birthday is on January 1, 1991.

Mandatory retirement age is the age set by your employer at which you would have been required to retire, had you not become disabled.

U.S. citizen or resident. You must be a U.S. citizen or resident to claim the credit. Generally, you may not claim the credit if you were a nonresident alien at any time during the tax year. However, if you are a nonresident alien who is married to a U.S. citizen or resident at the end of the tax year and you both choose to be treated as U.S. residents and be taxed on your worldwide income, you may claim the credit.

Also, if you were a nonresident alien at the beginning of the year and a resident at the end of the year, and you were married to a U.S. citizen or resident at the end of the year, you may both choose to be treated as U.S. residents for the entire year and thus be allowed to claim the credit. For information on these choices, see Publication 519, *U.S. Tax Guide for Aliens.*

Qualified Individual Under Age 65

If you are under 65, you may qualify for the credit only if you are retired on permanent and total disability.

You are considered retired, even if you do not retire formally, when you have stopped working because of your disability. You are retired on permanent and total disability if:

- You were permanently and totally disabled when you retired, and
- You retired on disability before the close of the tax year.

If you retired on disability before 1977, and were not permanently and totally disabled at that time, you can qualify for the credit if you were permanently and totally disabled on January 1, 1976, or January 1, 1977.

Permanent and total disability. You are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or that the condition can be expected to result in death. See *Physician's statement,* later.

Substantial gainful activity. Substantial gainful activity is your performance of significant duties over a reasonable period of time in work for pay or profit, or in work generally done for pay or profit.

Full-time work or part-time work done at the employer's convenience, in a competitive work situation for at least the minimum wage, conclusively shows that you are able to engage in a substantial gainful activity. The minimum wage is $3.35 an hour during the period ending March 31, 1990, and $3.80 an hour during the year beginning April 1, 1990.

Substantial gainful activity is not work you do to take care of yourself or your home. It is not unpaid work on hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities. But, the kind of work you do may show that you are able to engage in substantial gainful activity. The fact that you have not worked for some time is not, of itself, conclusive evidence that you cannot engage in substantial gainful activity. The following examples illustrate the tests of substantial gainful activity.

Example 1. Sue, a sales clerk, retired on disability. She is 53 years old and now works as a full-time babysitter for the minimum wage. Even though Sue is doing different work, she is able to do the duties of her new job in a full-time competitive work situation for the minimum wage. She is able to engage in substantial gainful activity and, therefore, cannot take the credit.

Example 2. Tom, a bookkeeper, retired on disability. He is 59 years old and now drives a truck for a chatable organization. He sets his own hours and is not paid. Duties of this nature generally are performed for pay or profit. Some weeks he works 10 hours, and some weeks he works 40 hours. Over the year he averages 20 hours a week. The kind of work and his average hours a week conclusively show that Tom is able to engage in substantial gainful activity. This is true even though Tom is not paid and he sets his own hours. He cannot take the credit.

Example 3. John, who retired on disability, took a job with a former employer on a trial basis. The purpose of the job was to see if John could do the work. The trial period lasted for 6 months during which John was paid the minimum wage. Because of John's disability, he was assigned only light duties of a nonproductive "make-work" nature. The activity was gainful because John was paid at least the minimum wage. But the activity was not substantial because his duties were nonproductive. These facts do not, by themselves, show that John is able to engage in substantial gainful activity.

Example 4. Joan, who retired on disability from employment as a bookkeeper, lives with her sister who manages several motel units. Joan assisted her sister for one or two hours a day by performing duties such as washing dishes, answering phones, registering guests, and bookkeeping. Joan can select the time during the day when she feels most fit to perform the tasks undertaken. Work of this nature, performed off and on during the day at Joan's convenience, is not activity of a "substantial and gainful" nature even if she is paid for the work. The performance of these duties does not, of itself, show that Joan is able to engage in substantial gainful activity.

Sheltered employment. Certain work offered at qualified locations to physically or mentally impaired persons is considered sheltered employment. These locations are in sheltered workshops, hospitals and similar institutions, homebound programs, and Department of Veterans Affairs sponsored homes. Compared to commercial employment, pay is lower in sheltered employment. Therefore, impaired persons usually do not look for sheltered employment if they can get other employment. The fact that an impaired person has accepted sheltered employment is not proof of that person's ability to engage in substantial gainful activity.

Disability income. Disability income is the total amount you are paid under your employer's (1) accident or health plan for personal injuries or sickness, or (2) pension plan (including annuities), that is included in your income as wages or payments in lieu of wages for the time you are absent from work because of permanent and total disability. Any payment you receive from a plan that does not provide for disability retirement is not disability income. Any lump-sum payment for accrued annual leave that you receive when you retire on disability is a salary payment and is not disability income. For the credit, disability income does ***not*** include any amount you receive from your employer's pension plan after you reach mandatory retirement age. For more information on disability income, see Chapter 11.

Physician's statement. If you are under 65, a doctor must certify that you are permanently and totally disabled. You must complete Part II of Schedule R (Form 1040) or of Schedule 3 (Form 1040A). However, the Physician's Statement does not have to be completed this year if:

1) Due to your continued disability you were unable to engage in any substantial gainful activity in 1990, and
2) You filed a statement in an earlier year. The statement must have met one of these two conditions:
   - If filed for a tax year before 1984, it must have been for the same disability, or
   - If filed for a tax year after 1983, the doctor must have signed on line B of the statement.

If you have not filed a doctor's statement in a previous year, or if the statement you filed did not meet one of these conditions, your doctor must complete the statement.

Veterans. If the Department of Veterans Affairs (VA) certifies that you are permanently and totally disabled, you can file Form 6004, *Certification of Permanent Total Disability,* instead of the physician's statement. Form

6004 must be signed by a person authorized by the VA to do so. You can get Form 6004 from the VA.

Married Taxpayers

Generally, if you are married at the end of the tax year, you and your spouse must file a joint return to claim the credit. If you and your spouse did not live in the same household at any time during the tax year, you may file either a joint return or separate returns and still take the credit.

If you are married, living with your child and apart from your spouse, you may be considered unmarried. See *You are considered unmarried* under *Head of Household* in Chapter 2, for the tests you must meet.

Figuring the Credit

If you want the IRS to figure your tax and credits, including the credit for the elderly or the disabled, see *Tax Figured by IRS* in Chapter 31.

If you figure the credit yourself on Schedule R or Schedule 3, you must:

1) Determine the ***base amount*** you may use, and
2) Subtract from that base amount:
   a) Any ***nontaxable social security*** and other nontaxable pensions and disability benefits you received, and
   b) Part of your ***adjusted gross income,*** depending on the level of your income.

The credit is 15% of the amount determined to be your base amount reduced by the items shown in (2). The steps to determine these amounts are explained in the following sections. In certain cases, the amount of your credit may be limited. See *Limitation on Credit,* later.

Base Amount

To figure the credit, you must first determine your base amount. You will use this base amount in your calculation to figure your credit. If you are a qualified individual under age 65, your base amount cannot be more than your taxable disability income for the tax year.

Except as provided in *Under age 65,* next, the base amount used to figure your credit is:

$5,000 if you are a qualified individual and your filing status is single, a head of household, or a qualifying widow or widower.

$5,000 if you are married filing a joint return and only one of you is a qualified individual.

$7,500 if you are married filing a joint return and both of you are qualified individuals.

$3,750 if you are a qualified individual, and your filing status is married filing a separate return, and you and your spouse did not live in the same household at any time during the tax year.

Under age 65. If you are a qualified individual under age 65 and you have disability income (defined earlier) of less than $5,000, your base amount is limited to the amount of your disability income. If you are married filing a joint return and both you and your spouse are qualified individuals under age 65, and the total disability income for both of you is less than $7,500, your base amount is limited to the total disability income for both of you. If you are married filing a joint return and one of you is age 65 or older and the other is a qualified individual under age 65, your base amount is $5,000 plus the disability income of the spouse under age 65, but not more than $7,500.

Nontaxable Social Security

Once you have determined your base amount, you must reduce it by the total amount of nontaxable social security and certain other nontaxable payments (covered later) you receive during the year. If you are married filing a joint return, you must reduce your base amount by the total amount of nontaxable payments both you and your spouse receive. You figure the amount of the nontaxable payments on lines 13a through 13c of Schedule R or Schedule 3.

Use the worksheet in the Form 1040 or Form 1040A instructions to determine if any part of your social security benefits (or equivalent railroad retirement benefits, if applicable) are taxable. The nontaxable portions are used to reduce your base amount.

Subtract the total of the following payments from your base amount.

- Social security payments that are not taxed. This includes the gross amount of nontaxable social security benefits, including disability benefits, before deducting any amounts that are withheld to pay premiums on supplementary Medicare insurance, and before any reduction because of receipt of a benefit under workers' compensation. Do not include a lump-sum death benefit payment you may receive as a surviving spouse, or a surviving child's insurance benefit payments you may receive as a guardian. If you are married filing a separate return and either you or your spouse or both of you live in a community property state, your social security benefits will be your separate property.
- Social security equivalent part of tier 1 railroad retirement pension payments that are not taxed.
- Nontaxable pension or annuity payments or disability benefits that are paid under a law administered by the Department of Veterans Affairs (VA). Do not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity under Section 808 of the Foreign Service Act of 1980.
- Pension or annuity payments or disability benefits that are excluded from income under any provision of federal law other than the Internal Revenue Code. Amounts that are a return of your cost of a pension or annuity do not reduce your base amount.

It is important that you correctly report these nontaxable amounts since these figures are verified through information supplied by other government agencies. Errors may result in a proposed credit adjustment to your return.

Community property. Married persons living apart and not filing a joint return may be able to disregard certain community property laws when figuring the credit. If either you or your spouse or both are domiciled in a community property state, see *Spouses Living Apart* in Publication 555, *Federal Tax Information on Community Property,* for more information. In applying the rules discussed in Publication 555, treat your retirement and disability pay, other than social security and equivalent railroad retirement benefits, as earned income. Social security and equivalent railroad retirement benefits are not community income.

Adjusted Gross Income Limit

You may also have to subtract the amount of your "excess" adjusted gross income (AGI) from the base amount used to figure your credit. Your excess AGI is one-half of the amount that your AGI is more than a set amount based on your filing status.

You figure your **excess AGI** as follows.

1) Subtract from your AGI the amount shown for your filing status in the list below:
   - $7,500 if you are single, a head of household, or a qualifying widow or widower, or
   - $10,000 if you are married filing a joint return, or
   - $5,000 if you are married filing a separate return and you and your spouse did not live in the same household at anytime during the tax year.
2) Divide the result of (1) by 2.

You figure your excess adjusted income on lines 14 through 17 of Schedule R or Schedule 3.

You will not be able to claim the credit if—

You are single, a head of household, or a qualifying widow or widower and receive nontaxable social security or other nontaxable pensions or disability benefits of $5,000 or more, or have adjusted gross income of $17,500 or more.

You are married filing a joint return, only one spouse is a qualified individual, and together you receive nontaxable social security or other nontaxable pensions or disability benefits of $5,000 or more, or have adjusted gross income of $20,000 or more.

You are married filing a joint return, both of you are qualified individuals, and together you receive nontaxable social security or other nontaxable pensions or disability benefits of $7,500 or more, or have adjusted gross income of $25,000 or more.

You are married filing a separate return and you and your spouse did not live in the same household at any time during the tax year, and you receive nontaxable social security or other nontaxable pensions or disability benefits of $3,750 or more, or have adjusted gross income of $12,500 or more.

Note. If your base amount is limited to your disability income, the amount of income that will keep you from taking the credit will be less than the amounts listed above. See *Base Amount,* earlier.

In addition, you will not be able to claim the credit if the total of your nontaxable social security or other nontaxable pensions or disability benefits plus your excess adjusted gross income on line 17 of Schedule R or Schedule 3 equals or is more than your base amount.

Example. You are 66 years old and your spouse is 64. Your spouse is not disabled. You file a joint return on Form 1040. Your adjusted gross income is $14,630. Together you received $3,200 from social security, which was nontaxable. You figure the credit as follows:

Base amount		$5,000
Subtract the total of:		
Social security and other nontaxable pensions	$3,200	
Excess adjusted gross income [($14,630 − $10,000) ÷ 2]	2,315	5,515
Balance (Not less than -0-)		-0-
Credit		-0-

You may not take the credit since your nontaxable social security plus your excess

adjusted gross income is more than your base amount.

Limitation on Credit

Your credit may be limited if:

1) You file Schedule C, D, E, or F (Form 1040), and
2) The amount on Form 1040, line 23, is more than:
   - $30,000 if you are single or head of household;
   - $40,000 if married filing jointly or qualifying widow or widower; or
   - $20,000 if married filing separately.

For purposes of the above test, any tax-exempt interest from private activity bonds issued after August 7, 1986, and any net operating loss deduction must be added to the amount from Form 1040, line 23.

If both of the above conditions do not apply, your credit is not subject to this limit. If you meet both conditions, you must complete **Form 6251**, *Alternative Minimum Tax—Individuals*, to determine your tentative minimum tax (before the alternative minimum tax foreign tax credit), and file Form 1040. The limit on your credit will be the smaller of:

1) Your credit as computed, or
2) Your regular tax minus:
   a) Any credit for child and dependent care expenses, and
   b) Any amount shown on line 15, Form 6251.

If the smaller of 1) or 2) is 2), enter that amount on Schedule R, line 21, and on Form 1040, line 42. Also write "AMT" on the dotted line to the left of line 42, Form 1040.

Schedule R and Schedule 3

If you qualify for the credit, complete Schedule R or Schedule 3 and attach it to your Form 1040 or Form 1040A when you file your return. There are separate instructions available for each schedule, which you should use to help you complete it.

If you file Form 1040 and you want the IRS to figure your credit, see *Form 1040*, under *Tax Figured by IRS* in Chapter 31.

If you file Form 1040A and you want the IRS to figure your credit, see *Form 1040A*, under *Tax Figured by IRS* in Chapter 31.

Examples

The following examples illustrate the credit for the elderly or the disabled. Assume that none of the taxpayers in these examples had to file a Form 6251.

Example 1. John Ash is single and 68 years old. He received the following income for the year:

Social security received	$3,120
Interest (taxable)	215
Pension (taxable part)	3,600
Wages from a part-time job	4,245

John's adjusted gross income is $8,060 ($4,245 + $3,600 + $215). The social security benefits are nontaxable. John figures the credit as follows:

Base amount		$5,000
Subtract the total of:		
Social security and other nontaxable pensions	$3,120	
Excess adjusted gross income [($8,060 − $7,500) ÷ 2]	280	3,400
Balance		$1,600
Credit (15% of $1,600)		$ 240

John's credit is $240. He shows this amount on line 42 of Form 1040.

Example 2. James Davis is age 58 and single. Two years ago he retired on permanent and total disability, and he is still permanently and totally disabled. He filed the required physician's statement with his return for the year he retired on disability, so this year he checks the box in Part II of Schedule R. This year he received nontaxable social security disability benefits of $3,000, a taxable disability pension of $8,400, and $100 interest. His adjusted gross income is $8,500 ($8,400 + $100). He figures his credit for the elderly or the disabled as follows:

Base amount		$5,000
Taxable disability pension		$8,400
Smaller of these amounts		$5,000
Subtract the total of:		
Nontaxable disability benefits (social security)	$3,000	
Excess adjusted gross income [($8,500 − $7,500) ÷ 2]	500	3,500
Balance		$1,500
Credit (15% of $1,500)		$ 225

His credit is $225. He enters $225 on line 42 of Form 1040.

Example 3. Bill White is 45. His wife, Helen, is 41. Bill had a stroke in 1984 and retired on permanent and total disability. He is still permanently and totally disabled because of the stroke. In November of this year, Helen was injured in an accident at work and retired on permanent and total disability.

Bill received nontaxable social security disability benefits of $3,000 this year and a taxable disability pension of $6,000. Helen earned $9,200 from her job and received a taxable disability pension of $1,000. Their joint return shows adjusted gross income of $16,200 ($6,000 + $9,200 + $1,000).

Helen got her doctor to complete Part II of Schedule R. Bill had filed a physician's statement with their return for the year he had the stroke. His doctor had checked box B to certify that Bill was permanently and totally disabled. Bill does not have to file another physician's statement this year. He checks the box in Part II and writes his first name in the space above line 2.

Bill and Helen use Schedule R to figure their $135 credit for the elderly or the disabled. They enter this amount on line 42 of Form 1040. See their filled-in Schedule R in this chapter.

Schedule R (Form 1040)

Department of the Treasury
Internal Revenue Service

Credit for the Elderly or the Disabled

► For Paperwork Reduction Act Notice, see Form 1040 Instructions.
► Attach to Form 1040. ► See separate Instructions for Schedule R.

OMB No. 1545-0074

1990

Attachment Sequence No. 16

Name(s) shown on Form 1040: Bill M. and Helen A. White

Your social security number: 222 : 00 : 2222

You may be able to use Schedule R to reduce your tax if by the end of 1990:

- You were 65 or older, **OR**
- You were under 65, you retired on **permanent and total** disability, and you received taxable disability income.

But you must also meet other tests. See the separate Instructions for Schedule R.
Note: *In most cases, IRS can figure the credit for you. See page 19 of the Form 1040 Instructions.*

Part I Check the Box That Applies to Your Filing Status and Age (Check only one box.)

If your filing status is:	And by the end of 1990:		Check box:
Single*	1	You were 65 or older	1 ☐
	2	You were under 65 and you retired on permanent and total disability	2 ☐
* Includes head of household and qualifying widow(er) with dependent child			
Married filing a joint return	3	Both spouses were 65 or older	3 ☐
	4	Both spouses were under 65, but only one spouse retired on permanent and total disability	4 ☐
	5	Both spouses were under 65, and both retired on permanent and total disability	5 ☒
	6	One spouse was 65 or older, and the other spouse was under 65 and retired on permanent and total disability	6 ☐
	7	One spouse was 65 or older, and the other spouse was under 65 and **NOT** retired on permanent and total disability	7 ☐
Married filing a separate return	8	You were 65 or older and you did not live with your spouse at any time in 1990	8 ☐
	9	You were under 65, you retired on permanent and total disability, and you did not live with your spouse at any time in 1990	9 ☐

Note: *If you checked Box 1, 3, 7, or 8, skip Part II and complete Part III on the back. All others, complete Parts II and III.*

Part II Statement of Permanent and Total Disability (Complete **only** if you checked Box 2, 4, 5, 6, or 9 above.)

IF: 1 You filed a physician's statement for this disability for 1983 or an earlier year, or you filed a statement for tax years after 1983 and your physician signed line B on the statement, **AND** Bill

2 Due to your continued disabled condition, you were unable to engage in any substantial gainful activity in 1990, check this box. ► ☒

If you checked this box, you do not have to file another statement for 1990. If you did **not** check this box, have your physician complete the following statement:

Physician's Statement

I certify that Helen A. White
(Name of disabled person)

was permanently and totally disabled on January 1, 1976, or January 1, 1977, **OR** was permanently and totally disabled on the date he or she retired. If retired after December 31, 1976, enter the date retired. ► November 2, 1990

Physician: Sign your name on **either** line A or B below.

A The disability has lasted, or can be expected to last, continuously for at least a year. John Doctor (Physician's signature) 2/7/91 (Date)

B There is no reasonable probability that the disabled condition will ever improve. (Physician's signature) (Date)

Physician's name: John A. Doctor

Physician's address: 101 Green St., Hometown, MD 20000

Instructions for Physician's Statement

Taxpayer

If you retired after December 31, 1976, enter the date you retired in the space provided in Part II.

Physician

A person is permanently and totally disabled when—

- He or she cannot engage in any substantial gainful activity because of a physical or mental condition; and
- A physician determines that the disability:
  1. has lasted, or can be expected to last, continuously for at least a year; or
  2. can be expected to lead to death.

(Continued on back)

Part III Figure the Amount of Your Credit

10	**If you checked (in Part I):** **Enter:** Box 1, 2, 4, or 7 . . . . . $5,000 Box 3, 5, or 6 . . . . . $7,500 Box 8 or 9 . . . . . $3,750					10	7,500 00
	Caution: *If you checked Box 2, 4, 5, 6, or 9 in Part I, you* ***MUST*** *complete line 11 below. Otherwise, skip line 11 and enter the amount from line 10 on line 12.*						
11	If you checked Box 6 in Part I, enter on line 11 the taxable disability income of the spouse who was under age 65 **PLUS** $5,000. Otherwise, enter on line 11 your taxable disability income (and also your spouse's if you checked Box 5 in Part I) that you reported on Form 1040. (For more details on what to include, see the Instructions.)					11	7,000 00
12	If you completed line 11 above, compare the amounts on lines 10 and 11, and enter the smaller of the two amounts here. Otherwise, enter the amount from line 10					12	7,000 00
13	Enter the following pensions, annuities, or disability income that you (and your spouse if you file a joint return) received in 1990 (see Instructions):						
	a Nontaxable part of social security benefits; and Nontaxable part of railroad retirement benefits treated as social security.			13a	3,000 00		
	b Nontaxable veterans' pensions; and Any other pension, annuity, or disability benefit that is excluded from income under any other provision of law.			13b			
	c Add lines 13a and 13b. (Even though these income items are not taxable, they **must** be included here to figure your credit.) If you did not receive any of the types of nontaxable income listed on line 13a or 13b, enter -0- on line 13c			13c	3,000 00		
14	Enter the amount from Form 1040, line 32	14	16,200 00				
15	**If you checked (in Part I):** **Enter:** Box 1 or 2 . . . . . $7,500 Box 3, 4, 5, 6, or 7 . . . $10,000 Box 8 or 9 . . . . . $5,000	15	10,000 00				
16	Subtract line 15 from line 14. Enter the result. If line 15 is more than line 14, enter -0-	16	6,200 00				
17	Divide the amount on line 16 by 2. Enter the result			17	3,100 00		
18	Add lines 13c and 17. Enter the total					18	6,100 00
19	Subtract line 18 from line 12. Enter the result. If the result is zero or less, stop here; you **cannot** take the credit. Otherwise, go to line 21					19	900 00
20	Decimal amount used to figure the credit					20	x .15
21	Multiply the amount on line 19 by the decimal amount (.15) on line 20. Enter the result here and on Form 1040, line 42. **Caution:** *If you file Schedule C, D, E, or F (Form 1040), your credit may be limited. See the Instructions for line 21 for the amount of credit you can claim.*					21	135 00

35. Other Credits

Important Change for 1990

Earned income credit. For tax years beginning in 1990, if your earned income is less than $20,264 and you have a child who lives with you for more than half the year, you may be entitled to a credit. The credit could be as much as $953.

In addition to the child and dependent care credit (Chapter 33) and the credit for the elderly or the disabled (Chapter 34), you may be able to claim other tax credits. This chapter discusses some of these other credits.

The chapter is divided into two parts. The first part, *Nonrefundable Credits*, discusses three credits that you subtract directly from your tax. These credits may reduce your tax to zero. If they are more than your tax, the excess is not refunded.

The second part, *Refundable Credits*, covers four credits that are refundable and treated as payments. These four credits are added to the federal income tax withheld from your salary and wages and to any estimated tax payments you made. If the total of these credits is more than your total tax, the excess will be refunded to you.

Nonrefundable Credits

The following credits are discussed in this part:

Minimum tax credit,

Mortgage interest credit, and

Foreign tax credit.

Minimum Tax Credit

You may be eligible to take a minimum tax credit against your regular income tax, if you paid alternative minimum tax after 1986. The credit is the part of your alternative minimum tax that was based on adjustments or preference items, such as depreciation, that defer tax. These items are called "deferrals." No credit is allowed on the part of your alternative minimum tax based on adjustment or preference items, such as personal exemptions, that cause a permanent avoidance of tax. These items are called "exclusions."

The credit for 1990 is based on your 1989 alternative minimum tax (reduced by the amount of the tax based on exclusions) plus any unused credit carryforward from years after 1986. You can carry forward any unused minimum tax credit to later years until it is completely used.

Use **Form 8801,** *Credit for Prior Year Minimum Tax,* to figure your 1990 credit and any carryforward to 1991.

For additional information about the credit and an illustrated example, get Publication 909, *Alternative Minimum Tax for Individuals.*

Mortgage Interest Credit

Mortgage credit certificates issued by state and local governments may entitle a certificate holder to a mortgage interest credit. The certificate must be used in connection with the purchase, qualified rehabilitation, or qualified home improvement of the certificate holder's main home.

Who qualifies. You may be able to claim a mortgage interest credit if you were issued a qualified mortgage credit certificate (MCC) under a qualified MCC program. The MCC must relate to your main home.

Amount of credit. You figure the credit by multiplying the certificate credit rate by the interest you paid during the year on the covered loan amount. The certificate credit rate and the covered loan amount are shown on the MCC.

Limitation. If the certificate credit rate is more than 20%, the credit cannot be more than $2,000.

Dividing the interest. If two or more persons (other than a married couple filing a joint return) hold an interest in the home to which the MCC relates, the credit must be divided in proportion to the interest held by each person.

Example. John and his brother, George, were issued a qualified MCC. They used the certificate to obtain a mortgage on a home that is their main home. John has a 60% interest and George has a 40% interest. John paid $5,400 mortgage interest in 1990 and George paid $3,600.

The MCC shows a credit rate of 25%. The covered loan amount (mortgage) is $60,000. Because the credit rate is more than 20%, the credit is limited to $2,000.

John's credit is limited to $1,200 ($2,000 × 60%). He figures the credit by multiplying the interest he paid in 1990, $5,400, by the certificate credit rate, (25%), for a total of $1,350. His credit is limited to the $1,200 above.

George's credit is limited to $800 ($2,000 × 40%). He figures the credit by multiplying the interest he paid in 1990, $3,600, by the certificate credit rate, 25%, for a total of $900. His credit is limited to the $800 above.

Since the entire $2,000 credit was used, the excess ($150 for John and $100 for George) cannot be carried forward to 1991, regardless of the tax liabilities for John and George. See *Carryforward,* next.

Carryforward. If your allowable credit is more than your tax liability reduced by certain credits, you can carry forward the unused portion of the credit to your next 3 tax years or until used, whichever comes first.

If you are subject to the $2,000 limitation because your certificate credit rate is more than 20%, no amount over the $2,000 (or your prorated share of the $2,000 if you must allocate the credit) may be carried forward.

Reduced interest deduction. If you itemize your deductions on Schedule A (Form 1040), reduce your home mortgage interest deduction by the amount of mortgage interest credit figured before you add in any credit carryforwards from previous years. For more information about the home mortgage interest deduction, see Chapter 24.

How to claim the credit. Figure the credit and any carryforward to next year on **Form 8396,** *Mortgage Interest Credit,* and attach it to your Form 1040. Be sure to include any carryforward from 1987, 1988, and 1989. You cannot use a carryforward from 1987 on your tax return for any year after 1990.

Include the credit in your total for line 46, Form 1040. Enter "MIC" (mortgage interest credit) and the amount on the dotted line next to line 46.

Foreign Tax Credit

You generally can choose to claim income taxes you paid or accrued during the year to a foreign country or U.S. possession as a credit against your U.S. income tax. Or, you can deduct them as an itemized deduction.

To take the foreign tax credit, complete **Form 1116,** *Foreign Tax Credit,* and attach it to your Form 1040. Enter the credit on line 43, Form 1040. For more information, get Publication 514, *Foreign Tax Credit for Individuals.*

Refundable Credits

The following credits are refundable and are treated as payments of tax:

- Earned income credit,
- Credit for excess social security tax or railroad retirement tax withheld,
- Credit from a regulated investment company, and
- Credit on diesel-powered highway vehicles.

Earned Income Credit

You may be entitled to a refundable credit of up to $953 if your earned income and your adjusted gross income are each less than $20,264. Your adjusted gross income is on line 16, Form 1040A, or line 32, Form 1040. If the credit is larger than your tax, the difference will be refunded to you. Even if you are not required to file a return, you should file to get a refund if you are eligible for this credit.

If you want, the IRS will figure your tax and the earned income credit (if eligible) on Form 1040 or Form 1040A. See *Tax Figured by IRS* in Chapter 31.

Caution. As this publication was being prepared for print, Congress was considering changes in the tax law that would increase the earned income credit for 1991. For additional information on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes.*

Advance earned income credit payments. If you think you will be eligible for the earned income credit for 1991, you can choose to get the credit in advance. Your employer will include a portion of the credit regularly in your pay.

You must file a tax return if you received any advance earned income credit payments in 1990.

How to get advance payments. To get the credit in advance, you must fill out Form W–5, *Earned Income Credit Advance Payment Certificate.* Give the bottom part of the form to your employer. Keep the top part for your records. If you have more than one employer, you may give a certificate to only one of them. If you are married and both you and your spouse are employed, you may give a Form W–5 to your employer, and your spouse may give a Form W–5 to his or her employer.

The Form W–5 you give to your employer for 1991 is good until December 31, 1991. If you expect to qualify for the earned income credit in 1992 and you want to receive advance payments, you must give your employer a new Form W–5.

Earned income limit. Your employer is not required to continue making advance payments to you once your earned income reaches $21,246 for 1991. This is because you will no longer be eligible for the credit.

If your status changes. If any of the information you provided on your Form W–5 changes, you must fill out a new form to give to your employer. You must give your employer a new form if:

You no longer qualify for the earned income credit,

Your spouse files a Form W–5 with his or her employer, or

You no longer want to get advance payments.

Filing your return. If you receive advance payments for any year, you ***must*** file Form 1040 or Form 1040A to report the amount received for that year even if you are not otherwise required to file an income tax return. You cannot file Form 1040EZ.

If you receive advance payments of the earned income credit in 1991 and later find that you do not qualify for the credit, you will have to pay it back when you file your Form 1040 or Form 1040A for 1991.

Alternative minimum tax. You must reduce the amount of your earned income credit by your alternative minimum tax, if any. See *Alternative minimum tax* under *How to figure the credit*, later.

To be eligible for the credit for 1990:

1) You must have a child living with you for more than half the year (for the whole year if the child is a foster child or if your filing status is qualifying widow(er) with dependent child),
2) Your main home must be in the United States,
3) You must have earned income during the year,
4) Your earned income and adjusted gross income must each be less than $20,264,
5) You must not have excluded from your gross income any income earned in foreign countries, or have deducted or excluded a foreign housing amount,
6) Your tax return must be for a 12-month period (this does not apply if a short period return is filed because of an individual's death),
7) Your filing status must be married filing joint return, qualifying widow(er) with dependent child, or head of household, and
8) You usually must file a joint return if you are married. See *Married taxpayers*, next, for an exception.

If you do not qualify for the credit, enter "No" on line 28c of Form 1040A or line 57 of Form 1040.

Married taxpayers. If you are married, you and your spouse usually must file a joint return to claim the credit. Even though you are married, you can file as head of household and claim the earned income credit if you meet the tests discussed in Chapter 2 under *Head of Household*.

Your child. If your filing status is ***married filing joint return*** or ***qualifying widow(er)*** with dependent child, your "child" means your:

Son,

Daughter,

Stepchild,

Legally adopted child,

Child placed with you by an authorized placement agency for adoption by you, or

Foster child (any other child, such as a grandchild, whom you care for as your own).

You generally must be able to claim an exemption for your child. You do not have to claim an exemption for your child if your spouse is not your child's parent and the child's other parent is allowed to claim the exemption under one of the exceptions discussed later.

If your filing status is ***head of household,*** your "child" means your:

Son,

Daughter,

Stepchild,

Legally adopted child, or

A descendant of your son, daughter, or adopted child (such as a grandchild).

You do not have to claim an exemption for your child who is unmarried. You generally must claim an exemption for your child who is married unless the child's other parent is allowed to claim the exemption under one of the exceptions discussed later.

If during the year you adopted a child, or a child was placed with you for adoption or became your stepchild, then the more-than-half-the-year or whole-year home requirement is considered satisfied if your home was this child's home from the date the child was adopted, placed with you, or became your stepchild, through the end of the year.

If your child was born, or died, during the year, the more-than-half-the-year or whole-year home requirement is considered satisfied if your home was your child's home during the part of the year that your child was alive.

Exceptions. You do not have to claim the exemption if you would have been able to claim it except (a) you released your claim to your child's other parent, in writing, or (b) the exemption was granted to the other parent in a pre–1985 agreement (such as a separation agreement or divorce decree).

A foster child is treated as your child if the child lived with you and was a member of your household for the **whole** year. A foster child is a child you care for as your own. A child is not your foster child if the natural or adoptive parents provide more than half the child's support for the tax year.

Earned income. Wages, salaries, tips, other employee compensation, net earnings from self-employment, and union strike benefits are earned income. Earned income includes anything of value (money, goods, or services) you get from your employer for services you performed, regardless of whether it is taxable.

Earned income of a member of the military includes the nontaxable Basic Allowance for Quarters and Basic Allowance for Subsistence.

If you have your own business, you must include your net earnings in earned income, even if they are less than $400. Net earnings is the amount you get after you take the deduction for one-half of your self-employment taxes (that deduction is allowed for tax years beginning after 1989). This can be deducted on Form 1040, line 25. Losses from your business will reduce earned income. You can figure the net earnings from your business by using the regular or the optional methods of figuring self-employment tax. If you are eligible to choose the optional method, you can use up to $1,600 as the amount of earned income for figuring your earned income credit, as well as your self-employment tax. Get Publication 533, *Self-Employment Tax*, for more information.

Income exempt from self-employment tax as a result of the filing and approval of Form 4361 (relating to the clergy) is earned income if it is wages, salaries, tips, or other employee compensation. This includes housing allowances or the rental value of a parsonage that you receive as part of your pay for services as an employee.

Income exempt from self-employment tax as a result of the filing and approval of Form 4029 (relating to members of certain religious faiths) is not earned income for purposes of the earned income credit. Wages, salaries, tips, or other employee compensation that is exempt from social security tax as a result of filing Form 4029 is earned income for purposes of this credit.

Earned income does not include interest, dividends, welfare benefits (including AFDC payments), veterans' benefits, pensions or annuities, alimony, social security payments, workers' compensation, or unemployment compensation. It also does not include taxable scholarships or fellowships not reported on Form W–2.

How to figure the credit. You figure your credit by using the following worksheet and the *Earned Income Credit Table* near the end of this publication.

1)	Enter amount from line 7, Form 1040 or Form 1040A, and include your taxable scholarship or fellowship income that is on your W–2	$
2)	Enter the total amount of your nontaxable earned income	
3)	Add lines 1 and 2. Enter the total	$
4)	If you were self-employed, enter amount of income or (loss) from Schedule SE, Section A, line 3, or Section B, line 3, less amount on line 25, Form 1040	
5)	Earned income. Add lines 3 and 4	$
6)	Enter the amount of your adjusted gross income from line 32, Form 1040 (line 16, Form 1040A)	$
7)	If line 6 is ***less than $10,750,*** use the amount from line 5 above to find your credit in the *Earned Income Credit Table*. This is your credit	$
8)	If line 6 is ***at least $10,750:***	
	a) Find the amount from line 5 above in the *Earned Income Credit Table* and enter the credit for that amount here	$
	b) Find the amount from line 6 above in the *Earned Income Credit Table* and enter the credit for that amount here	$
	c) Enter the smaller of line 8a or line 8b here. This is your credit	$

Example. John and Mary Green have a dependent child and are eligible for the earned income credit. John's salary was $11,935. Mary is self-employed and has a loss of $400 from her business. Mary did not use the optional method of figuring self-employment tax. The Greens received $100 interest income. They figure their credit using the worksheet as follows:

1)	Enter amount from line 7, Form 1040 or Form 1040A, and include your taxable scholarship or fellowship that is on your W–2	$11,935
2)	Enter the total amount of your nontaxable earned income	
3)	Add lines 1 and 2. Enter the total	$11,935
4)	If you were self-employed, enter amount of income or (loss) from Schedule SE, Section A, line 3, or Section B, line 3, less amount on line 25, Form 1040	(400)
5)	Earned income. Add lines 3 and 4	$11,535
6)	Enter the amount of your adjusted gross income from line 32, Form 1040 (line 16, Form 1040A)	$11,835
7)	If line 6 is ***less than $10,750,*** use the amount from line 5 above to find your credit in the *Earned Income Credit Table*. This is your credit	

8) **If line 6 is *at least $10,750*:**

a) Find the amount from line 5 above in the *Earned Income Credit Table* and enter the credit for that amount here $873

b) Find the amount from line 6 above in the *Earned Income Credit Table* and enter the credit for that amount here $863

c) Enter the smaller of line 8a or line 8b here. This is your credit ..... $ 863

Alternative minimum tax. Reduce your earned income credit (line 8c on worksheet above) by any alternative minimum tax liability on your return. See Chapter 31 in this publication for more information about alternative minimum tax.

How to claim your credit. To receive your credit, you must file a tax return. Enter your earned income credit on line 57, Form 1040, or line 28c, Form 1040A. If you received nontaxable compensation from your employer, enter "NE" on the dotted line to the left of line 57, Form 1040, or in the space to the left of line 28c, Form 1040A.

Include any advance earned income credit payments on line 53, Form 1040 or line 26, Form 1040A. The advance payments you received are shown on your Form W–2, Box 8. You must file a tax return if you received any advance earned income payments in 1990.

For more information, see Publication 596, *Earned Income Credit.*

Credit for Excess Social Security Tax (FICA) or Railroad Retirement Tax (RRTA) Withheld

If you worked for two or more employers during 1990 and together they paid you more than $51,300 ($38,100 if you are covered under the tier 2 railroad retirement system) in wages, too much FICA tax or RRTA tax may have been withheld from your wages. If the total FICA tax or tier 1 RRTA tax withheld was more than $3,924.45, or the total tier 2 RRTA tax withheld was more than $1,866.90, you can claim the extra amount as a credit to reduce your income tax when you file your return.

If any one employer withheld FICA or RRTA tax that exceeds the tax amounts above, you cannot claim the extra amount as a credit to reduce your income tax. Your employer must adjust this for you.

If you are filing a joint return, you cannot add the FICA or RRTA tax withheld from your spouse's income to the amount withheld from yours. Figure the credit separately.

If you file Form 1040, enter the credit on line 59. If you file Form 1040A or Form 1040EZ, add the credit to the federal income tax that was withheld and report the total on line 28d of Form 1040A or on line 6 of Form 1040EZ. Write "Excess SST" and show the amount of the credit in the space to the left of the line.

If you did not work for a railroad during the year, figure the credit as follows:

1) Total social security tax withheld by all employers in 1990. (Do not include more than $3,924.45 for any one employer.)	$
2) Total uncollected social security tax on tips, from all 1990 Form(s) W–2	
3) Total. Add lines (1) and (2)	$
4) Social security tax limit	$ 3,924.45
5) Credit. Subtract line (4) from line (3).	$

Example. You are married. Your spouse had no gross income in 1990. You file a joint return in 1990. During 1990 you worked for the Brown Shoe Company and earned $35,000 in wages. Social security (FICA) tax of $2,677.50 was withheld. You also worked for another employer in 1990 and earned $20,000 in wages. $1,530.00 of FICA taxes was withheld from these wages. Because you worked for more than one employer and your total wages were more than $51,300, you can claim a credit of $283.05 for the excess FICA taxes withheld. The $283.05 is the excess of $4,207.50 ($2,677.50 + $1,530.00) less $3,924.45. Enter the $283.05 as a credit against your income tax on line 59, Form 1040, line 28d, Form 1040A, or line 6 of 1040EZ.

If you worked for a railroad and were subject to RRTA tax, you should figure your credit as follows:

1) Total social security and tier 1 railroad retirement tax withheld by all employers in 1990. (Do not include more than $3,924.45 for any one employer.)	$
2) Total uncollected social security and tier 1 railroad retirement tax on tips, from all 1990 Form(s) W–2	
3) Total. Add lines (1) and (2)	$
4) Limit	3,924.45
5) Subtract line (4) from line (3). (If less than zero, enter zero.)	
6) Total tier 2 railroad retirement tax withheld by all railroad employers in 1990. (Do not include more than $1,866.90 for any one employer.)	
7) Total uncollected tier 2 railroad retirement tax on tips, from all 1990 Forms W–2	
8) Total. Add lines (6) and (7)	$
9) Limit	1,866.90
10) Subtract line (9) from line (8). (If less than zero, enter zero.)	
11) Credit. Add lines (5) and (10)	$

You should use this worksheet if you had railroad retirement tax or both railroad retirement and social security tax withheld during the year.

If you are a railroad employee representative, you may have wages or self-employment income under the social security program, compensation as a railroad employee, or any combination of these. If the total of this income added to your compensation as an employee representative under the railroad retirement program is more than $51,300, do not figure your credit as described. You must figure your credit on **Form 4469,** *Excess Medicare Tax Credit,* and include it on line 61, Form 1040. Write "Form 4469" and the amount of the credit on the dotted line next to this total. You cannot claim this credit on Form 1040A or Form 1040EZ.

Government employees. The pay of certain federal, state, and local government employees is subject only to the hospital insurance (Medicare) portion of FICA. The tax for this portion is 1.45% of up to $51,300 in wages received during 1990. Therefore, the maximum amount that can be withheld for Medicare in 1990 is $743.85 (1.45% of $51,300).

If during 1990 you received pay from the federal government, a state, or a local government that was subject only to the 1.45% Medicare tax, and pay from another government job or pay from a job that was subject to FICA or RRTA tax, and your total wages were more than $51,300, you may have had more than the maximum amount of Medicare tax withheld. You can claim the excess as a credit against your income tax.

To claim this credit, use **Form 4469,** *Excess Medicare Tax Credit.* Include the credit in the total on Form 1040, line 61. Write "Form 4469" and the amount of the credit on the dotted line next to this total. You cannot claim the credit on Form 1040A or Form 1040EZ.

Two or more other employers. If in addition to your government wages reported on line 1 of Form 4469, you received wages in excess of $51,300 from two or more other employers, you may be entitled to a credit for excess FICA or RRTA tax. After you complete Form 4469, figure any excess FICA or RRTA tax on the appropriate worksheet in this discussion. Enter on line 1 of the worksheet only the FICA or RRTA tax withheld; do not enter the Medicare tax withheld on the government wages you reported on line 1 of Form 4469.

Credit from a Regulated Investment Company

You must include in your income any amounts that an investment company allocated to you as capital gain distributions, even if you did not actually receive them. If the investment company paid a tax on the capital gain, you are allowed a credit for the tax since it is considered paid by you. The company will send you **Form 2439,** *Notice to Shareholder of Undistributed Long-term Capital Gains,* telling you the undistributed capital gains amount and the tax paid, if any. You claim the credit by entering the amount on line 61, Form 1040, and attaching Copy B of Form 2439 to your return. See *Capital Gain Distributions* in Chapter 9 for more information on undistributed capital gains.

Credit on Diesel-Powered Highway Vehicles

If you purchased a diesel-powered highway vehicle for a use other than resale, and you are the first owner of the vehicle, you may be entitled to a one-time credit in the year of purchase. The credit is $102 if you purchased a diesel-powered automobile and $198 if you purchased a diesel-powered light truck or van.

To claim the credit or refund, complete line 1 of **Form 4136,** *Credit for Federal Tax on Fuels,* and attach it to Form 1040. Enter the credit on line 60, Form 1040.

For more information, see the discussion of *Diesel-Powered Cars, Vans, Light Trucks* in Publication 378, *Fuel Tax Credits and Refunds.*

Part VII
Sample Returns

The three chapters in this part give examples of filled-in tax returns. The first chapter illustrates Form 1040EZ. The second chapter illustrates Form 1040A with some of the schedules that may need to be filled out and filed with it. The third chapter illustrates Form 1040 with many of the schedules and forms that may need to be filled out and filed with it.

36. Form 1040EZ

Pat Brown is single and has no dependents. She is 22 years old and a full-time student at State University where she has a scholarship which covers her tuition and $500 of her room and board. Her parents are able to claim her as a dependent. In January of this year, she received her Form W–2 which shows she earned $1,850 in wages and had $250 in Federal tax withheld during 1990. She also received a Form 1099–INT showing she had $277 in interest income for 1990. Pat filed Form 1040EZ in 1989, so the IRS sent her the Form 1040EZ tax package. Since she meets all the requirements for using Form 1040EZ (see *Which Form to Use,* in Chapter 1), she decides to use it again for 1990.

To make processing her return quicker and to speed her refund, Pat prints (does not type) her numbers and keeps them inside the boxes on her Form 1040EZ. She does not use dollar signs. She rounds off cents to whole dollars.

Name, Address, and Social Security Number

Pat uses the mailing label that came with her forms package. The label has her name, address, and social security number. She checks the label to make sure it is correct. However, she does not put the label on her tax return until the return is completed and she is sure it is accurate.

Pat would use the label even if some of the information on it was incorrect. She would make the necessary changes directly on the label and then place it on her completed return.

Presidential Election Campaign Fund. Pat wants one dollar of her taxes to go to this fund, so she checks the "Yes" box. Checking "Yes" will not change her tax or reduce her refund.

Report Your Income

Pat has two items of income which must be combined and entered on line 1 of Form 1040EZ. The part of her scholarship that is for room and board ($500) is taxable. She adds this amount to her wages ($1,850) which are shown in Box 10 of her Form W–2. Pat enters the total ($2,350) on line 1. On line 2, she enters her interest income of $277. Pat has no tax-exempt interest, so she does not have to write "TEI" and show any amount to the left of line 2. She adds her wages, taxable scholarship, and interest together to figure her adjusted gross income of $2,627. She enters $2,627 on line 3.

Standard deduction and personal exemption. If Pat could not be claimed as a dependent by her parents or someone else, she would have a standard deduction amount of $3,250 and a personal exemption of $2,050. She would enter $5,300 on line 4.

However, since she can be claimed as a dependent by her parents, Pat checks the "Yes" box on line 4. She uses the worksheet on the back of her Form 1040EZ to figure her standard deduction. Her completed worksheet is shown below. She enters the result ($2,350) on line 4.

A. Enter the amount from line 1 on front.	A.	2,350
B. Minimum amount.	B.	500
C. **Compare** the amounts on lines A and B above. Enter the **LARGER** of the two amounts here.	C.	2,350
D. Maximum amount.	D.	3,250
E. **Compare** the amounts on lines C and D above. Enter the **SMALLER** of the two amounts here and on line 4 on front.	E.	2,350

Note. Because Pat checked the "Yes" box on line 4, and because her parents can claim her as a dependent on their own tax return, she cannot claim an exemption for herself.

Pat subtracts line 4 ($2,350) from line 3 ($2,627) and enters the result of $277 on line 5. This amount is Pat's taxable income. She will figure her income tax on this amount.

Figure Your Tax

Pat had $250 of federal income tax withheld from her wages by her employer. She found this amount in Box 9 of her 1990 Form W–2. She enters this amount on line 6 of Form 1040EZ.

Note. If Pat wanted the IRS to compute her tax for her, she would stop at this point. She would make sure lines 1 through 6 were accurately completed, then she would sign and date the return.

Pat decides to compute her tax by herself. She takes the amount on line 5, her taxable income of $277, and goes to the Tax Table. She reads down the income column of the Tax Table until she finds the line that includes her taxable income shown on line 5 of her Form 1040EZ.

If she uses the tax table in Section 3 of the Form 1040EZ package, she then reads across the line to find her tax ($43).

If she uses the tax table in this publication, she then reads across the line to find the Single column. The amount shown at the point the income line and the filing status column meet is her tax ($43).

She enters this amount on line 7 of her Form 1040EZ.

Refund or Amount You Owe

Pat compares line 6 and line 7. Since line 6 is larger, she subtracts line 7 ($43) from line 6 ($250) to arrive at her refund of $207. She enters this amount on line 8. Pat will receive a tax refund of $207.

If her employer had not withheld any federal income tax from her wages, Pat would have owed $43 in income tax. She would have been instructed to enter that amount on line 9. She would then attach a check or money order for the full amount of $43, payable to "Internal Revenue Service." She would write on the front of her check or money order:

"1990 Form 1040EZ,"

Her social security number,

Her daytime telephone number, and

Her address.

Sign Your Return

Pat goes back over her return to make sure she entered the numbers clearly and correctly and that she did the math correctly.

Pat signs and dates her return at the bottom of the form. Now that she has filled in her Form 1040EZ, she takes her pre-printed mailing label from the front of her forms package and places it in the address portion at the top of her return. She attaches Copy B of her Form W–2 to the location indicated on the front of Form 1040EZ.

She makes a copy of her filled-in tax return for her records. Then she mails her return to the Service Center in the envelope that came with her forms package.

A filled-in copy of Pat's return follows.

Filled-in Form 1040EZ **If you need more information, turn to the page shown in the circle.**

Department of the Treasury - Internal Revenue Service

Form **1040EZ** **Income Tax Return for Single Filers With No Dependents** **1990**

OMB No. 1545-0675

Name & address Use IRS label (see page 9). If you don't have one, please print.

CAR-RT SORT**CRO1
PB 571-00-4684 S29 Z1
PAT A BROWN
3408 UNION ST 203
HOMETOWN MD 21214

(9)

IRS

Please print your numbers like this: 9 8 7 6 5 4 3 2 1 0

Your social security number

(9)

Please see instructions on the back. Also, see the Form 1040EZ booklet.

Presidential Election Campaign (see page 9) Do you want $1 to go to this fund? Yes [X] No [ ]

Note: Checking "Yes" will not change your tax or reduce your refund. ▶

		Dollars	Cents
Report your income			
(39) (47) 1 Total wages, salaries, and tips. This should be shown in Box 10 of your W-2 form(s). (Attach your W-2 form(s).) 1		12,350	.00
Attach Copy B of Form(s) W-2 here. Attach tax payment on top of Form(s) W-2. (48) 2 Taxable interest income of $400 or less. If the total is more than $400, you cannot use Form 1040EZ. 2		277	.00
3 Add line 1 and line 2. This is your **adjusted gross income.** 3		12,627	.00
(112) 4 Can your parents (or someone else) claim you on their return? *Note: You must check Yes or No.* [X] Yes. Do worksheet on back; enter amount from line E here. [ ] No. Enter 5,300.00. This is the total of your standard deduction and personal exemption. (112) 4		2,350	.00
(160) 5 Subtract line 4 from line 3. If line 4 is larger than line 3, enter 0. This is your **taxable income.** 5		10,277	.00
Figure your tax 6 Enter your Federal income tax withheld from Box 9 of your W-2 form(s). 6		1,250	.00
7 **Tax.** Use the amount on line 5 to find your tax in the tax table on pages 14-16 of the booklet. Enter the tax from the table on this line. 7		1,043	.00
Refund or amount you owe (12) 8 If line 6 is larger than line 7, subtract line 7 from line 6. This is your **refund.** 8		207	.00
9 If line 7 is larger than line 6, subtract line 6 from line 7. This is the **amount you owe.** Attach your payment for full amount payable to "Internal Revenue Service." Write your name, address, social security number, daytime phone number, and "1990 Form 1040EZ" on it. 9			.00

Sign your return **I have read this return. Under penalties of perjury, I declare that to the best of my knowledge and belief, the return is true, correct, and complete.**

Keep a copy of this form for your records.

Your signature Date

(10) X Pat A. Brown 2-15-91

For IRS Use Only—Please do not write in boxes below.

Form 1040EZ (1990)

37. Form 1040A

Don and Jean Smith are a married couple with two young children. Don worked full time as a carpenter during 1990 until November when he retired on a pension. Jean works full time as a secretary. She was laid off for a few weeks during the year and received unemployment compensation. Their one-year-old son, Todd, went to a day-care center while both were working. Their seven-year-old daughter, Lynn, stayed with a neighbor before and after school.

The Smiths filed Form 1040A in 1989 so the IRS sent them the Form 1040A tax package this year. Since they meet all the requirements for using Form 1040A (see *Which Form to Use* in Chapter 1), they decide to use it again in 1990.

Step 1—Name, Address, and Social Security Number

Don and Jean use the label that came with their forms package. The label has their names, address, and social security numbers. They check the label to make sure it is correct, but they do not put it on the return until they have completed and checked the return to make sure it is accurate. If they use the label, their tax return can be processed faster.

The Smiths should use the label even if some of the information on it is incorrect. They would make any necessary changes directly on the label.

Presidential Election Campaign Fund. Don and Jean each want $1 of their taxes to go to this fund. They check both *Yes* boxes. Checking *Yes* does not increase their tax or reduce their refund.

Step 2—Filing Status

Don and Jean must choose their filing status before they figure their tax liability.

Filing status (lines 1–5). Don and Jean check the box on line 2 to file a joint return. Because they are married and living together, they must file a joint return in order to claim the child care credit.

Step 3—Exemptions

Don and Jean must indicate the number of exemptions they can claim.

Exemptions (lines 6a–e). Don and Jean can take two personal exemptions, one for each of them. They check these exemptions in the boxes on lines 6a and 6b and enter the total (2) on the line at the right. On line 6c, they write their children's names and enter "2" on the line "lived with you" at the right.

They have to enter the social security number for any dependent who is 2 or older. They write Lynn's social security number in column 3. Since Todd was not yet 2 at the end of 1990, they check the box by his name in column 2. They write their children's relationship to them (daughter and son) in column 4 and enter "12" (the number of months each child lived with them) in column 5 for each child. They do not have any other dependents, so in the box on line 6e they enter "4" as the total number of exemptions.

Step 4—Total Income

Don and Jean report their income on **lines 7–13b** and total it on **line 14.**

Wages (line 7). Don's Form W–2, *Wage and Tax Statement,* shows he earned $19,250 in 1990. Jean's Form W–2 shows she earned $15,155. They find these amounts in Box 10 of their Forms W–2. They add the amounts together and put the total, $34,405, on line 7.

Interest income (lines 8a–b and Part I of Schedule 1). Don and Jean received a statement (Form 1099–INT) from their bank showing they earned $410 of taxable interest income last year. Since their interest income is over $400, they must list the name of the bank and the amount received in Part I of Schedule 1. They also enter this amount on line 8a. They also received $35 of tax-exempt interest from a municipal bond. They enter $35 on line 8b. This amount does not increase their taxable income.

Dividends (line 9). Don and Jean opened an account in a mutual fund last year. They received a statement from the fund showing they earned dividends of $20. They also received a statement from the XYZ Corporation showing they earned dividends of $80 last year. Because the total amount of their dividends is not over $400, they do not have to list them in Part II of Schedule 1. They enter the total amount of their dividends, $100, on line 9.

Pensions (lines 11a–b). Don received Form W–2P, *Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA payments* from his employer's retirement plan showing pension distributions of $1,000. The taxable amount is shown in Box 10. Because Don's pension is fully taxable, he enters the $1,000 on line 11b; no entry is required on line 11a.

Unemployment compensation (line 12). Jean was laid off for ten weeks in 1990. Her state sent her a Form 1099–G, *Statement for Recipients of Certain Government Payments,* showing $1,010 in unemployment compensation during this period. She enters this amount on line 12.

Total (line 14). In addition to the Form 1099–G Jean received for her unemployment compensation, Don and Jean also received a Form 1099–G showing a state tax refund they received in 1990. Because they did not itemize deductions on their 1989 federal return, they do not have to report the refund as income in 1990. Therefore, their total income is the sum of the amounts shown on lines 7, 8a, 9, 11b, and 12. Don and Jean add these lines and enter the total, $36,925, on line 14.

Step 5—Adjusted Gross Income

Don and Jean figure their **adjusted gross income** on **lines 15 and 16.**

IRA deduction (lines 15a–c). In 1990, Don contributed $750 to his IRA and Jean contributed $650 to hers. Jean also contributed an additional $100 to her IRA in January 1991 and asked that it be counted for 1990. They complete lines 1–3 of *IRA Worksheet 1* (shown below) in their forms instruction package to figure how much of their contributions they can deduct. The entire amount of their contributions to both IRAs is deductible. They enter $750 for Don on line 15a and $750 for Jean on line 15b. The sum of their IRA contributions to both IRAs, $1,500, is entered on line 15c.

Adjusted gross income (line 16). Don and Jean subtract their total IRA deduction on line 15c from their total income on line 14. They enter the result, $35,425, on line 16 and on line 17. This amount is their adjusted gross income. Since it is more than $20,264, they do not qualify for the earned income credit.

Step 6—Taxable Income

Don and Jean figure their **taxable income** on **lines 17–22.**

Standard deduction (lines 18a–c and 19). Lines 18a–c do not apply to either Don or Jean. They enter their standard deduction amount of $5,450 (see Chapter 21) on line 19. They subtract their standard deduction on line 19 from their adjusted gross income on line 17 and enter the result, $29,975, on line 20.

Exemptions (line 21) Then, Don and Jean deduct $2,050 for each exemption they claimed on line 6e. They multiply $2,050 by 4 (the number of exemptions shown on line 6e) and enter the result, $8,200, on line 21. They subtract the amount on line 21, $8,200, from the amount on line 20, $29,975, and put the difference, $21,775, on line 22. This amount is their taxable income.

Step 7—Tax, Credits, and Payments

Next, Don and Jean figure their tax liability.

Tax (line 23). Don and Jean must use the Tax Table in the forms instructions package to find their tax. The Smiths' taxable income from line 22 is $21,775. Don and Jean first look for the large print **21,000** in the table. Under this, they look down to income of at least 21,750, but less than 21,800. Their taxable income is between these two amounts. They then find their tax, $3,266, in the column for married filing jointly. They put this amount on line 23 and check the box for "Tax Table."

Credit for child and dependent care expenses (line 24a and Schedule 2). Don and Jean paid $4,000 of qualified expenses in 1990 for the care of their children while they worked. Their son, Todd, went full time to a day-care center. The cost for his care was

IRA Worksheet 1
(keep for your records)

		(a) Your IRA	(b) Your working spouse's IRA
1. Enter IRA contributions you made for 1990, but **do not enter more than $2,000 in either column.**	1.	750	750
2. Enter wages, salaries, and tips for each person, from Form 1040A, line 7.	2.	19,250	15,155
3. Compare the amounts on lines 1 and 2. Enter the **smaller** of the two amounts on line 3. Enter on Form 1040A, line 15a, the amount from line 3, column (a). Enter on Form 1040A, line 15b, the amount, if any, from line 3, column (b). If married filing a joint return and contributions were made to your nonworking spouse's IRA, go to line 4.	3.	750	750

$3,000. Their daughter, Lynn, was cared for by a neighbor before and after school. The neighbor also cared for the children when school was not in session. They paid the neighbor $1,000. Their employers did not provide any dependent care benefits.

Don and Jean prepare Parts I and II of Schedule 2. They enter the names, addresses, and taxpayer identification numbers (employer identification number and social security number) of the day-care center and the person that provided the care in 1990 on line 1, columns a, b, and c.

The Smiths enter the amounts they paid to the child-care providers on line 1, column d, and enter the total of these amounts, $4,000, on line 2. Because they had qualified expenses for two children, they enter "2" on line 3. On line 4 they enter the amount of qualified expenses, $4,000, they paid when both parents were working. They enter $4,800 on lines 5 and 7 because they paid for the care of two children. They make no entry on line 6 because none of the care was provided by employers. On line 8 they enter the amount from line 4, $4,000, since it is less than the amount on line 7, $4,800. On lines 9 and 10 they each enter their earned income. Jean's income was the smaller of the two so they enter her income again on line 11. Because their child-care expenses were less than Jean's earned income, all the expenses can be used to figure the credit. They enter these expenses, $4,000, again on line 12. Then they check the table on line 13 to see what percentage of these expenses they can take as a credit.

Since the Smiths' adjusted gross income on line 17 of Form 1040A ($35,425) is over $28,000, they can take 20% of $4,000, or $800, as their credit. They put .20 on line 13 and $800 on line 14. Because their credit is less than their tax, they can use all of it to reduce their federal income tax liability. They enter this credit on line 24a of Form 1040A.

Total tax (line 27). Don and Jean leave line 24b blank because they do not claim a credit for the elderly or the disabled. They subtract their total credits on line 24c ($800) from the tax on line 23 ($3,266) and enter the difference, $2,466, on lines 25 and 27. The amount on line 27 is their total tax liability.

Total payments (lines 28a–d). Don and Jean then check Box 9 of their Forms W–2 and Box 11 of Form W–2P for the amount of Federal income tax withheld from their wages and pension. Don's Form W–2 shows $1,806 tax withheld and Jean's Form W–2 shows $1,248 tax withheld. Don's Form W–2P shows no withholding because he elected not to have taxes withheld from his pension in 1990 since he was expecting a refund. The Smiths did not make any estimated tax payments for 1990. Their total payments are $3,054. They enter this amount on lines 28a and 28d. They are not entitled to the earned income credit on line 28c.

Step 8—Refund or Amount You Owe

The tax withheld from the Smiths' wages is more than their total tax. They subtract their tax on line 27, $2,466, from their total payments shown on line 28d, $3,054, and enter the difference, $588, on lines 29 and 30. This is the amount that will be refunded to them.

If Don and Jean had not had at least $2,466 withheld for federal income tax, they would have owed tax. They would have entered the difference between their tax (line 27) and their withholding (line 28d) on line 32. They would then attach a check or money order for the full amount owed (line 32), payable to "Internal Revenue Service." They would also write "1990 Form 1040A," a daytime telephone number, address, and Don's social security number (since his name and social security number are listed on the return first) on the front of their check or money order.

Step 9—Sign Your Return

Don and Jean sign and date their return and list their occupations. Then they check their return to make sure it is accurate and complete. They remove the mailing label from the forms package and put it in the address portion on the top of the form. Then they attach Copy B of their Forms W–2 and W–2P to the location indicated on the front of their return.

They use the envelope that came with their forms package to mail their return to the Service Center. Don and Jean save a copy of the return for their records.

1 Control number

2 Employer's name, address, and ZIP code
Carpentry Inc.
1718 Upland Blvd.
Hometown, MI 48001

6 Statutory employee | Deceased | Pension plan | Legal rep. | 942 emp. | Subtotal | Deferred compensation | Void

7 Allocated tips

8 Advance EIC payment

9 Federal income tax withheld: 1,806.00

10 Wages, tips, other compensation: 19,250.00

3 Employer's identification number: 10-1111111

4 Employer's state I.D. number: 10-111 11 11

11 Social security tax withheld: 1,472.62

12 Social security wages: 19,250.00

5 Employee's social security number: 329-00-1000

13 Social security tips

14 Nonqualified plans

19 Employee's name, address and ZIP code
Don B. Smith
2210 Midland Street
Hometown, MI 48001

15 Dependent care benefits

16 Fringe benefits incl. in Box 10

17

18 Other

20 | 21 | 22 | 23

24 State income tax: 975.82

25 State wages, tips, etc.: 19,250.00

26 Name of state: MI

27 Local income tax

28 Local wages, tips, etc.

29 Name of locality

Copy B To be filed with employee's FEDERAL tax return

Dept. of the Treasury—Internal Revenue Service

Form W-2 Wage and Tax Statement 1990

1 Control number

2 Employer's name, address, and ZIP code
United Lumber Co.
901 Timber Lane
Hometown, MI 48002

6 Statutory employee | Deceased | Pension plan | Legal rep. | 942 emp. | Subtotal | Deferred compensation | Void

7 Allocated tips

8 Advance EIC payment

9 Federal income tax withheld: 1,248.00

10 Wages, tips, other compensation: 15,155.00

3 Employer's identification number: 10-0000000

4 Employer's state I.D. number: 10-000 00 00

11 Social security tax withheld: 1,159.36

12 Social security wages: 15,155.00

5 Employee's social security number: 410-00-1111

13 Social security tips

14 Nonqualified plans

19 Employee's name, address and ZIP code
Jean S. Smith
2210 Midland Street
Hometown, MI 48001

15 Dependent care benefits

16 Fringe benefits incl. in Box 10

17

18 Other

20 | 21 | 22 | 23

24 State income tax: 564.35

25 State wages, tips, etc.: 15,155.00

26 Name of state: MI

27 Local income tax

28 Local wages, tips, etc.

29 Name of locality

Copy B To be filed with employee's FEDERAL tax return

Dept. of the Treasury—Internal Revenue Service

Form W-2 Wage and Tax Statement 1990

1 Control number

2 Payer's name, address, and ZIP code
Local #89 Carpenter's Union
2652 Northland Road
Hometown, MI 48003

3 Payer's Federal identification number: 10-9111119

4 Payer's state I.D. number: 10-911 11 19

5 State income tax withheld: 0

6 Name of state: MI

7 Tax and tax Allowance | Deceased | Legal rep. | Subtotal | IRA/SEP | Void

8 Recipient's social security no.: 329-00-1000

9 Gross annuity, pension, etc.: 1,000.00

10 Taxable amount: 1,000.00

11 Federal income tax withheld: 0

12 Recipient's name, address, and ZIP code
Don B. Smith
2210 Midland Street
Hometown, MI 48001

13

14 Distribution code

Copy B—File with recipient's FEDERAL tax return
This information is being furnished to the Internal Revenue Service.

Form W-2P 1990 Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury Internal Revenue Service

Filled-In Form 1040A **If you need more information, turn to the page shown in the circle.**

Form **1040A** — Department of the Treasury—Internal Revenue Service

U.S. Individual Income Tax Return 1990

OMB No. 1545-0085

Step 1 Label (See page 14.) Use IRS label. Otherwise, please print or type.

LABEL HERE

Your first name and initial: DS — Last name: DON B. & JEAN S. SMITH

Your social security no.: 329-00-1000

Spouse's social security no.: 410-00-1111

DO 18 2

Apt. no.: 2210 MIDLAND ST

IRS

HOMETOWN, MI 48001

For Privacy Act and Paperwork Reduction Act Notice, see page 3.

Presidential Election Campaign Fund (see page 15)

Do you want $1 to go to this fund? ☑ Yes ☐ No

If joint return, does your spouse want $1 to go to this fund? ☑ Yes ☐ No

Note: *Checking "Yes" will not change your tax or reduce your refund.*

Step 2 Check your filing status (Check only one.)

1 ☐ Single. (See page 16 to find out if you can file as head of household.)

2 ☑ Married filing joint return (even if only one had income)

3 ☐ Married filing separate return. Enter spouse's social security number above and spouse's full name here ▶

4 ☐ Head of household (with qualifying person). (See page 16.) If the qualifying person is your child but not your dependent, enter this child's name here ▶

5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 17.)

Step 3 Figure your exemptions (See page 17.)

6a ☑ **Yourself** If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. But be sure to check the box on line 18b on page 2.

6b ☑ **Spouse**

No. of boxes checked on 6a and 6b: 2

c Dependents: 1. Name (first, initial, and last name)	2. Check if under age 2	3. If age 2 or older, dependent's social security number	4. Dependent's relationship to you	5. No. of months lived in your home in 1990
Lynn Smith		410 00 7070	daughter	12
Todd Smith	✓		son	12

If more than 7 dependents, see page 20.

No. of your children on 6c who:
- lived with you: 2
- didn't live with you due to divorce or separation (see page 21):

No. of other dependents listed on 6c:

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶ ☐

e Total number of exemptions claimed. Add numbers entered on lines above: 4

Step 4 Figure your total income

Attach Copy B of your Forms W-2 and W-2P here.

Attach check or money order on top of any Forms W-2 or W-2P.

7 Wages, salaries, tips, etc. This should be shown in Box 10 of your W-2 form(s). (Attach Form(s) W-2.) — 7: 34,405

8a **Taxable** interest income (see page 23). (If over $400, also complete and attach Schedule 1, Part I.) — 8a: 410

b **Tax-exempt** interest. (DO NOT include on line 8a.) 8b: 35

9 Dividends. (If over $400, also complete and attach Schedule 1, Part II.) — 9: 100

10a Total IRA distributions. 10a — 10b Taxable amount (see page 24). 10b:

11a Total pensions and annuities. 11a — 11b Taxable amount (see page 25). 11b: 1,000

12 Unemployment compensation (insurance) from Form(s) 1099-G. — 12: 1,010

13a Social security benefits. 13a — 13b Taxable amount (see page 28). 13b:

14 Add lines 7 through 13b (far right column). This is your **total income.** ▶ 14: 36,925

Step 5 Figure your adjusted gross income

15a Your IRA deduction from applicable worksheet. 15a: 750

b Spouse's IRA deduction from applicable worksheet. Note: *Rules for IRAs begin on page 30.* 15b: 750

c Add lines 15a and 15b. These are your **total adjustments.** — 15c: 1,500

16 Subtract line 15c from line 14. This is your **adjusted gross income.** (If less than $20,264, see "Earned income credit" on page 38.) ▶ 16: 35,425

Filled-in Form 1040A — If you need more information, turn to the page shown in the circle.

1990 Form 1040A

Page 2

Step 6

17 Enter the amount from line 16. — 17 **35,425**

18a Check if: ☐ You were 65 or older ☐ Blind; ☐ Spouse was 65 or older ☐ Blind — Enter number of boxes checked ▶18a ☐

(112) b If your parent (or someone else) can claim you as a dependent, check here ▶18b ☐

c If you are married filing separately and your spouse files Form 1040 and itemizes deductions, see page 34 and check here ▶18c ☐

Figure your standard deduction, (114)

19 **Enter your standard deduction. See page 35 for the chart (or worksheet) that applies to you. Be sure to enter your standard deduction here.** — 19 **5,450**

20 Subtract line 19 from line 17. (If line 19 is more than line 17, enter -0-.) — 20 **29,975**

exemption amount, and

21 Multiply $2,050 by the total number of exemptions claimed on line 6e. — 21 **8,200**

taxable income

22 Subtract line 21 from line 20. (If line 21 is more than line 20, enter -0-.) This is your **taxable income.** — ▶22 **21,775**

(160)

Step 7

23 Find the tax on the amount on line 22. Check if from: ☑ Tax Table (pages 49–54) or ☐ Form 8615 (see page 36) — 23 **3,266**

Figure your tax, credits, and payments (168) (164)

24a Credit for child and dependent care expenses. Complete and attach Schedule 2. — 24a **800**

(176) b Credit for the elderly or the disabled. Complete and attach Schedule 3. — 24b

c Add lines 24a and 24b. These are your **total credits.** — 24c **800**

If you want IRS to figure your tax, see the instructions for line 22 on page 36.

(160) 25 Subtract line 24c from line 23. (If line 24c is more than line 23, enter -0-.) — 25 **2,466**

26 Advance earned income credit payments from Form W-2. — 26

27 Add lines 25 and 26. This is your **total tax.** — ▶27 **2,466**

(36) 28a Total Federal income tax withheld. (If any is from Form(s) 1099, check here ▶ ☐ .) — 28a **3,054**

b 1990 estimated tax payments and amount applied from 1989 return. — 28b

(181) c **Earned income credit.** See page 38 to find out if you can take this credit. — 28c

d Add lines 28a, 28b, and 28c. These are your **total payments.** — ▶28d **3,054**

Step 8

Figure your refund or amount you owe

(12) 29 If line 28d is more than line 27, subtract line 27 from line 28d. This is the amount you **overpaid.** — 29 **588**

30 Amount of line 29 you want **refunded to you.** — 30 **588**

(35) 31 Amount of line 29 you want **applied to your 1991 estimated tax.** — 31

Attach check or money order on top of Form(s) W-2, etc. on page 1.

(12) 32 If line 27 is more than line 28d, subtract line 28d from line 27. This is the **amount you owe.** Attach check or money order for full amount payable to "Internal Revenue Service." Write your name, address, social security number, daytime phone number, and "1990 Form 1040A" on it. — 32

(37) 33 Estimated tax penalty (see page 42). — 33

Step 9

Sign your return

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Keep a copy of this return for your records.

	Your signature	Date	Your occupation
	Don B Smith	4/10/91	Carpenter
	Spouse's signature (if joint return, BOTH must sign)	Date	Spouse's occupation
	Jan S. Smith	4/10/91	Secretary

Paid preparer's use only (10)

	Preparer's signature	Date	Check if self-employed ☐	Preparer's social security no.
	Firm's name (or yours if self-employed) and address		E.I. No.	
			ZIP code	

Filled-in Schedule 1 **If you need more information, turn to the page shown in the circle.**

Schedule 1 (Form 1040A)

Department of the Treasury – Internal Revenue Service

Interest and Dividend Income for Form 1040A Filers

1990

OMB No. 1545-0085

Name(s) shown on Form 1040A: Don B. and Jean S. Smith

Your social security number: 329 00 1000

Part I Interest Income

(See pages 23 and 44.) (48)

Complete this part and attach Schedule 1 to Form 1040A if:

- You have over $400 in taxable interest, or
- You are claiming the exclusion of interest from series EE U.S. savings bonds issued after 1989.

If you are claiming the exclusion or you received, as a nominee, interest that actually belongs to another person, see page 45.

Note: *If you received a Form 1099-INT, Form 1099-OID, or substitute statement, from a brokerage firm, enter the firm's name and the total interest shown on that form.*

1 List name of payer		Amount
First National Bank of Hometown	1	410
2 Add the amounts on line 1.	2	410
3 Enter the excludable savings bond interest, if any, from Form 8815, line 14. Attach Form 8815 to Form 1040A.	3	
4 Subtract line 3 from line 2. Enter the result here and on Form 1040A, line 8a.	4	410

Part II Dividend Income

(See pages 24 and 45.) (57)

Complete this part and attach Schedule 1 to Form 1040A if you received over $400 in dividends.

If you received, as a nominee, dividends that actually belong to another person, see page 45.

Note: *If you received a Form 1099-DIV, or substitute statement, from a brokerage firm, enter the firm's name and the total dividends shown on that form.*

5 List name of payer		Amount
	5	
6 Add amounts on line 5. Enter the total here and on Form 1040A, line 9.	6	

Filled-in Schedule 2

If you need more information, turn to the page shown in the circle.

Schedule 2 (Form 1040A)

Department of the Treasury—Internal Revenue Service

Child and Dependent Care Expenses for Form 1040A Filers

(169)

1990

OMB No. 1545-0085

Name(s) shown on Form 1040A: Don B. and Jean S. Smith

Your social security number: 329 00 1000

- If you are claiming the child and dependent care credit, complete Parts I and II below. But if you received employer-provided dependent care benefits, first complete Part III on the back.
- If you are not claiming the credit but you received employer-provided dependent care benefits, only complete Part I, below, and Part III on the back.

Part I

Persons or organizations who provided the care

You MUST complete this part. (See page 46.)

1	a. Name	b. Address (number, street, city, state, and ZIP code)	c. Identifying number (SSN or EIN)	d. Amount paid (see instructions)
	Anytime Daycare Center	100 Castle Street Hometown, MI 48002	30-000000	3,000
	Doris Hill	833 Fine Street Hometown, MI 48002	326-00-2000	1,000

(If you need more space, attach schedule.)

2 Add the amounts in column d of line 1 and enter the total. — 2: 4,000

Note: *If you paid cash wages of $50 or more in a calendar quarter to an individual for services performed in your home, you must file an employment tax return. Get* **Form 942** *for details.*

Part II

Credit for child and dependent care expenses

3 Enter the number of qualifying persons who were cared for in 1990. You must have shared the same home with the qualifying person(s). (See page 47 for the definition of a qualifying person.) — 3: 2

4 Enter the amount of **qualified** expenses you incurred and actually paid in 1990. See page 47 to find out which expenses qualify. **Caution:** *If you completed Part III on page 2, DO NOT include on this line any excluded benefits shown on line 23.* — 4: 4,000

5 Enter $2,400 ($4,800 if you paid for the care of two or more qualifying persons). — 5: 4,800

6 If you completed Part III on page 2, enter the **excluded benefits,** if any, from line 23. — 6:

7 Subtract line 6 from line 5. (If line 6 is equal to or more than line 5, STOP HERE; you cannot claim the credit.) — 7: 4,800

8 Compare the amounts on lines 4 and 7. Enter the **smaller** of the two amounts here. — 8: 4,000

9 You **must** enter your **earned income.** (See page 48 for the definition of earned income.) — 9: 19,250

10 If you are married filing a joint return, you **must** enter your spouse's earned income. (If spouse was a full-time student or disabled, see the instructions for the amount to enter.) — 10: 15,155

11 If you are married filing a joint return, compare the amounts on lines 9 and 10. Enter the **smaller** of the two amounts here. — 11: 15,155

12 • If you are married filing a joint return, compare the amounts on lines 8 and 11. Enter the **smaller** of the two amounts here.

• All others, compare the amounts on lines 8 and 9. Enter the **smaller** of the two amounts here. — 12: 4,000

13 Enter the decimal amount from the table below that applies to the **amount on Form 1040A, line 17.**

If line 17 is: Over—	But not over—	Decimal amount is:	If line 17 is: Over—	But not over—	Decimal amount is:
$0	10,000	.30	$20,000	22,000	.24
10,000	12,000	.29	22,000	24,000	.23
12,000	14,000	.28	24,000	26,000	.22
14,000	16,000	.27	26,000	28,000	.21
16,000	18,000	.26	28,000		.20
18,000	20,000	.25			

13: × .20

14 Multiply the amount on line 12 by the decimal amount on line 13. Enter the result here and on Form 1040A, line 24a. — 14 = 800

best copy available

38. Form 1040

Frank and Evelyn Jones are a married couple with two children. The sample tax return in this chapter is based on their situation. It shows the proper reporting of items on the tax forms.

Frank works full time as an electrician. He is also a partner in the Jones Brothers Partnership. Evelyn, a retired state government employee, is a partner in the Gateway Travel Agency. Frank and Evelyn own some stocks and bonds, and Frank owns rental property. He is also a beneficiary of a trust set up by his father.

In May 1990, Frank and Evelyn sold their home and moved to a new home in a nearby city. Soon after their move, they called the IRS and asked for Form 8822, *Change of Address.* They completed the form and mailed it to the Internal Revenue Service Center for their old address.

Because the IRS received Frank and Evelyn's Form 8822 before the address labels for the 1990 tax packages were prepared, their new address appears on the address label that came on their Form 1040 package for 1990. They do not put the label on their return until they have completed and checked the return to make sure it is accurate.

The forms they received in their tax package were based on the return and schedules they filed for 1989. They use the order blank in their tax package to order any other forms they need.

Presidential Election Campaign Fund. Frank and Evelyn each want $1 of their taxes to go to the Presidential Election Campaign Fund. They check both *Yes* boxes. Checking "Yes" will not increase their tax or reduce their refund.

Filing Status and Exemptions

Frank and Evelyn show their filing status and personal exemptions on lines 1–6e.

Filing status (lines 1–5). Because Frank and Evelyn decide to file a joint return, they check the filing status box on line 2, *Married filing joint return.*

Exemptions (lines 6a–6e). Frank and Evelyn show the exemption for Frank on line 6a and the exemption for Evelyn on line 6b. They enter "2" on the line to the right of lines 6a and b.

Their daughter, Marie, who is 18, earned $2,100 last year. Frank and Evelyn provided more than half her support. They claim Marie as a dependent on line 6c. The gross income test does not apply because she is under 19 and the other dependency tests were met. (See *Exemptions for Dependents* in Chapter 3.) Their son, James, who is 22, goes to a local college full time. During the summer, James earned $2,200, which he spent for his support. The gross income test does not apply because he is a full-time student under age 24. Frank and Evelyn provided more than $2,200 toward their son's support and the other dependency tests were met. On line 6c of the return, they claim James as a dependent. Frank and Evelyn write the information asked about Marie and James on line 6c, columns (1), (3), (4), and (5). They do not check column (2) because neither Marie nor James is under age 2. They enter "2" on the first line to the right of line 6c because both Marie and James lived at home.

Grace Smith, Evelyn's mother, lives with Frank and Evelyn and their two children. Grace gets a pension of $2,100 a year and social security of $1,800 a year. She spent this money for clothing and other personal things. Only $1,500 of her pension is gross income for her. The rest of the pension is not taxable because it is a return of her cost.

Frank and Evelyn paid a total of $7,000 for food for the family. They also paid Grace's medical and drug expenses of $500. The fair rental value of their house is $13,000 a year. Grace's total support is:

Expenses paid by Grace	$3,900
Expenses paid by Frank and Evelyn:	
Medical	500
Food—Grace's share (⅛ of $7,000)	1,400
Lodging—Grace's share (⅛ of $13,000)	2,600
Total support	$8,400

Because the support Frank and Evelyn provided is more than half of Grace's total support and Grace had less than $2,050 gross income, they can claim her as a dependent. They write the information asked about Grace on line 6c of their return.

Frank Jones and his two brothers provided $3,500 for the total support of their sister, Clara Jones. Frank provided 35%, one brother provided 35%, and the other brother provided the remaining 30%. Any one of them may claim the exemption for Clara if a written statement from each of the others is attached to the income tax return of the brother claiming the exemption. The brothers agree to let Frank claim Clara as his dependent this year. They each give Frank a signed Form 2120, *Multiple Support Declaration,* for Frank to attach to his return. (Forms 2120 are not shown.) Frank and Evelyn write the information asked about Clara on line 6c. They enter "2" on the third line to the right of line 6c for Grace and Clara.

They then enter "6" in the box to the right of line 6e to show the total exemptions they claim. They also enter $12,300 ($2,050 × 6) on line 36.

Income

Frank and Evelyn report the kinds of income they received for the year on lines 7–22.

Wages (line 7). Frank's Form W–2, *Wage and Tax Statement,* shows he earned $20,940. (Form W–2 is not shown here.) Frank and Evelyn enter $20,940 on line 7.

Interest income (lines 8a and 8b and Part I of Schedule B). Frank and Evelyn have two savings accounts and one tax-exempt municipal bond. The Forms 1099–INT that they received show that they had interest income of $330 from National Bank and $100 from First Savings and Loan. Because their total taxable interest income is more than $400, they must report it on Schedule B. In addition, they received $500 interest from the municipal bond. Since they did not receive a Form 1099–INT for this tax-exempt interest, they do not report it on Schedule B.

On line 1, Part I of Schedule B, they enter the names of the financial institutions and the interest received from each. They enter the total interest, $430, on line 2. They did not have excludable savings bond interest, so they leave line 3 blank and enter $430 on line 4, Schedule B, and on line 8a, Form 1040. They show the $500 tax-exempt interest on line 8b, Form 1040. The tax-exempt interest will not be included in their total income on line 23.

Dividends (line 9 and Part II of Schedule B). During 1990 Frank and Evelyn received or had credited to their accounts the following dividends and other corporate distributions:

Forms 1099–DIV

Acme Publishing Company	
Gross dividends, etc. (Box 1a)	$210
Ordinary dividends (Box 1b)	210
Zepco, Inc.	
Gross dividends, etc. (Box 1a)	$310
Ordinary dividends (Box 1b)	300
Nontaxable distributions (Box 1d)	10
Equity Money Market Fund	
Gross dividends, etc. (Box 1a)	$ 50
Ordinary dividends (Box 1b)	50
Tiger Mutual Fund	
Gross dividends, etc. (Box 1a)	$ 60
Capital gain distributions (Box 1c)	60
Equity Brokers	
Gross dividends, etc. (Box 1a)	$ 40
Ordinary dividends (Box 1b)	40

Schedule K–1 (Form 1065)

Frank's share of dividends on stock owned by his partnership	$ 80

Frank and Evelyn received more than $400 in dividends, so they must report them on Schedule B.

They list all payers and the total amount received from each payer on line 5, Part II of Schedule B. This includes capital gain distributions and nontaxable distributions. They show the total on line 6. Frank and Evelyn put their capital gain distributions of $60 from the Tiger Mutual Fund on line 7. (They also enter this amount on line 13, Part II of Schedule D because they must report other transactions they had during the year on Schedule D.) The $10 nontaxable distribution from Zepco, Inc., is entered on line 8. They reduce their basis in the stock by this amount.

Frank and Evelyn add the amounts on lines 7 and 8 and enter the total, $70, on line 9. They subtract this amount from the $750 on line 6 and enter the result, $680, on line 10, Part II of Schedule B, and on line 9, Form 1040.

Foreign accounts and foreign trusts (Part III of Schedule B). Evelyn has a foreign checking account that she uses for her travel agency. Because she had less than $10,000 in the account during 1990, she answers *No* to the question on line 11a in Part III of Schedule B. Neither Frank nor Evelyn was a grantor of, or transferor to, a foreign trust, so they answer *No* to the question on line 12 in Part III of Schedule B.

State and local income tax refunds (line 10). Frank and Evelyn received a state tax refund of $110 in 1990. This amount is shown on the Form 1099–G, *Statement for Recipients of Certain Government Payments,* sent to them by their state. They must report the refund as income on line 10 because they deducted the total state tax paid as an itemized deduction on their 1989 return and the deduction resulted in a tax benefit.

Capital gain or loss (line 13 and Schedule D). On line 13, Frank and Evelyn show their income from the sale or exchange of capital assets from Schedule D.

Frank and Evelyn received Forms 1099–B, *Statement for Recipients of Proceeds From Broker and Barter Exchange Transactions,* from their broker, reporting stock sales during 1990 totaling $7,400. They enter that total on line 1, Schedule D. Although they also

received a Form 1099–S, *Statement for Recipients of Proceeds From Real Estate Transactions*, they do not include the amount shown on that form because they are reporting the sale of their home on Form 2119. (See *Sale of Your Home*, later.)

Short-term capital gains and losses (Part I of Schedule D). In Part I of Schedule D they show their short-term capital gains and losses from assets they held one year or less. This year they had a short-term loss of $300 on the sale of stock they bought in 1989 and held for 5 months, and a short-term gain of $100 on the sale of stock they bought in January 1990 and held for 2 months. They list these transactions on line 2a.

In 1985 Frank lent $200 to a former coworker. The debt became worthless in May 1990. Because it is a nonbusiness bad debt, he reports it as a short-term capital loss on line 2d.

Frank and Evelyn also had a short-term capital loss carryover of $500 from 1989. They show this on line 6.

They add the amounts in column (f) of lines 2a through 6 and enter ($1,000), the total short-term loss, on line 7, column (f). They add the amounts in column (g) of lines 2a through 6 and enter $100, the total short-term gain, on line 7, column (g). They combine the amounts in columns (f) and (g), line 7, and enter their $900 net short-term loss on line 8.

Long-term capital gains and losses. In Part II of Schedule D, Frank and Evelyn show their long-term capital gains and losses from assets they held more than one year. On line 9a they show a $3,000 gain from the sale of stock and a $560 loss from a worthless bond. They also enter $300, Frank's share of long-term capital gain from his partnership, on line 12 and their $60 capital gain distributions on line 13. They do not report the sale of their home. (See *Sale of Your Home*, later.)

They add the amounts in column (f) of lines 9a through 15 and enter ($560) on line 16, column (f). They add the amounts in column (g) of lines 9a through 15 and enter $3,360 on line 16, column (g). They combine the amounts in columns (f) and (g), line 16, and enter their $2,800 net long-term gain on line 17.

Summary (Part III of Schedule D). In Part III of Schedule D they must summarize Parts I and II. They combine their $900 net short-term capital loss with their $2,800 net long-term capital gain and enter the result, $1,900, on line 18, Schedule D, and on line 13, Form 1040.

Caution. As this publication was being prepared for print, Congress was considering a proposal that would change the way long-term capital gains are figured. For information on any late legislative changes, see Publication 553, *Highlights of 1990 Tax Changes*.

Pensions (lines 17a and 17b). Evelyn retired in 1989 on her 63rd birthday. She received pension income of $850 in 1989 and $2,550 in 1990. $150 of her $9,000 pension cost was recovered tax free in 1989. Evelyn uses the worksheet in her forms instructions package to figure the taxable part of her pension for 1990. Her filled-in worksheet is shown here.

Worksheet for Simplified General Rule

1. Enter the total pension or annuity payments received this year. Also enter this amount on Form 1040, line 17a		$2,550
2. Enter your cost in the plan at the annuity starting date plus any death benefit exclusion		$9,000
3. Age at annuity starting date:	Enter:	
55 and under	300	
56 – 60	260	
61 – 65	240	
66 – 70	170	
71 and older	120 ...	240
4. Divide the amount on line 2 by the number on line 3. Enter the result		37.50
5. Multiply the amount on line 4 by the number of months for which this year's payments were made. Enter the result. If your annuity starting date was **before** 1987, also enter this amount on line 8; skip lines 6 and 7. Otherwise, go to line 6.		450
6. Enter the amount, if any, recovered tax free in years after 1986		150
7. Subtract line 6 from line 2. Enter the result		8,850
8. Compare the amounts on lines 5 and 7 above. Enter the smaller of the two amounts here		450
9. **Taxable amount.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also enter this amount on Form 1040, line 17b. If your Form W–2P shows a larger amount, use the amount on this line instead of the amount from Form W–2P		$2,100

Evelyn shows the total amount of her pension on line 17a, Form 1040. She shows the taxable amount, $2,100, on line 17b.

Rental, partnership, and trust income (line 18 and Schedule E). Frank and Evelyn show their total income from these sources on Schedule E and on line 18, Form 1040.

Rental income (Part I of Schedule E). Frank received rental income from two properties he owns, a store building and an unimproved piece of land. On line 1, Schedule E, he lists the building and its location in the space marked "A," and the land and its location in the space marked "B." On line 2, he checks the *No* box for both properties because neither was used for personal purposes.

On line 3, Frank enters his $8,400 rental income from the building in column A, his $720 rental income from the land in column B, and the total, $9,120, in column D. Then he lists expenses, such as insurance, interest, general repairs, and real estate taxes, on the appropriate lines in each column. On line 18, column A, he shows his transportation expenses connected with the rental of the building, figured at 26 cents a mile. He adds the expenses for each property and on line 19 enters $5,420 in column A, $100 in column B, and the total, $5,520, in column D.

Frank's records show that he purchased the store building in 1975. His basis is $40,000 and he is using the straight line method of depreciation with a 40-year life. Frank shows depreciation of $1,000 for 1990 on line 20 in columns A and D. Because the building was placed in service before 1981, he does not have to complete Form 4562, *Depreciation and Amortization*, or show his depreciation computation.

Frank enters the total expenses for each property on line 21, columns A and B. In each column he subtracts the amount on line 21 from the amount on line 3 and enters the result on line 22. He adds the amounts on line 22 and enters his total rental income, $2,600, on lines 24 and 26.

Partnership income (Part II of Schedule E). Frank is an active partner in the Jones Brothers Partnership. The following amounts are shown as his share of income and deductions on the Schedule K–1 (Form 1065) given to him by the partnership.

Ordinary income from trade or business	$4,600
Net long-term capital gain	300
Dividends	80
Charitable contributions	50
Net earnings from self-employment	4,600

Evelyn is an active partner in the Gateway Travel Agency. The following amounts are shown as her share of items on Schedule K–1 (Form 1065).

Ordinary income from trade or business	$1,900
Net earnings from self-employment	1,900

Frank and Evelyn list their partnerships in column (a) of line 27, in the spaces marked "A" and "B," and complete columns (b) and (d) for each. They are at risk for the amounts invested in each of their partnerships, so they check column (e). They do not complete Form 6198, *At-Risk Limitations*.

Because Frank and Evelyn actively participate in their partnerships' business activities, they report the ordinary business income from both of the partnerships as nonpassive income in column (k), line 27. They enter the total partnership income of $6,500 on lines 28a, 29, and 31.

Frank and Evelyn report their other partnership items as follows:

- Dividends—line 5 of Schedule B (see *Dividends (line 9 and Part II of Schedule B)*, earlier),
- Net long-term capital gain—line 12, column (g) of Schedule D (see *Capital gain or loss (line 13 and Schedule D)*, earlier),
- Contributions—line 14 of Schedule A (see *Itemized Deductions (Schedule A)*, later), and
- Net earnings from self-employment—line 2, Section A of Schedule SE (see *Other Taxes*, later).

Trust income (Part III of Schedule E). Frank had taxable income of $1,400 from a trust set up by his father. He shows the trust's name and employer identification number in columns (a) and (b) of line 32. He shows the $1,400 income as passive income in column (d). He also enters $1,400 in column (d) of line 33a, and on lines 34 and 36.

Summary (Part V of Schedule E). In Part V of Schedule E, Frank and Evelyn combine the amounts on lines 26, 31, and 36. They enter the total, $10,500, on line 40, Schedule E, and on line 18, Form 1040.

Other income (line 22). Frank won a $50 prize in a photography contest. Frank and Evelyn show this income on line 22, Form 1040.

Total income (line 23). Frank and Evelyn add the amounts on lines 7 through 22 to figure their total income, $36,710. They enter this amount on line 23.

Sale of Your Home (Form 2119)

Frank and Evelyn do not have a taxable gain on the sale of their home. However, they must report the sale on Form 2119, *Sale of Your Home*. Some of the expenses of the sale of the old home and the purchase of the new home qualify as a moving expense deduction.

Frank and Evelyn bought and moved into their new home May 1, 1990, and sold their old home May 2, 1990. They are over 55 and meet all of the tests for the once-in-a-lifetime exclusion of up to $125,000 of the gain on the sale. They choose to take the exclusion.

They received a Form 1099–S, *Statement for Recipients of Proceeds From Real Estate*

Transactions, showing gross proceeds of $160,000 from the sale of their old home. Their records also show the following items.

Old home		
Original basis (purchased 1965)		$ 18,000
Improvements		7,000
Adjusted basis		$ 25,000
Fixing-up expenses for sale		$ 1,000
Selling price		$ 160,000
Settlement charges at closing:		
Realtor's commission	$ 8,000	
Balance of mortgage	4,500	
Penalty for prepayment of mortgage	50	
Mortgage interest (4/1/90–5/1/90)	20	
Points—charged to seller (loan origination fee, 1%)	1,000	
Real estate taxes (1/1/90–5/1/90)	630	14,200
Net received		$ 145,800
New home		
Purchase price		$ 90,000
Settlement charges at closing:		
Title search, attorney fees, other settlement fees	$ 1,300	
Points charged to buyer (1%)	400	
Mortgage assumed	(40,000)	
Down payment	(5,000)	
Real estate taxes (1/1/90–4/30/90—credit from seller)	(300)	(43,600)
Balance due		$ 46,400

Frank and Evelyn first complete Form 3903, *Moving Expenses*, because they must decide which of the expenses of the sale of their old home and the purchase of their new home to claim as part of their moving expense deduction. Qualifying moving expenses include only the $8,000 realtor's commission and $1,000 points paid on the sale of their old home, and the $1,300 of settlement fees paid on the purchase of their new home. Because of the $3,000 limit on certain moving expenses, however, they decide to claim only $2,340 of the selling expenses of their old home as moving expenses. (See *Moving expenses* under *Itemized Deductions*, later.) They use the remaining $6,660 of selling expenses ($9,000 − $2,340) to reduce the amount they realized from the sale.

They deduct certain of the amounts paid when they sold their old home and purchased their new home as itemized deductions on Schedule A. Their itemized deduction for interest includes the $50 penalty for prepayment of the mortgage on their old home and the $400 points paid for the mortgage on their new home. (See *Interest you paid* under *Itemized Deductions*, later.)

Frank and Evelyn figure the amount realized and the gain realized on the sale of their old home as follows:

Selling price	$160,000
Less: Selling expenses	6,660
Amount realized	$153,340
Less: Adjusted basis	25,000
Gain realized	$128,340

They figure the adjusted basis of their new home as follows:

Gain realized—old home	$128,340
Less: Exclusion allowed	125,000
Gain postponed	$ 3,340
Purchase price—new home	$ 90,000
Plus: Settlement fees	1,300
Total cost	$ 91,300
Less: Gain postponed—old home	3,340
Adjusted basis — new home	$ 87,960

Frank and Evelyn put this information on the appropriate lines of Form 2119. They do not have to sign Form 2119 since they are attaching it to their tax return.

Adjustments to Income

Frank and Evelyn report their adjustments to income on lines 24a–30.

IRA deduction (lines 24a and 24b). Frank and Evelyn each made contributions to an individual retirement arrangement (IRA). Frank contributed $2,000 to his 1990 IRA. In February 1991, Evelyn contributed $900 to her IRA for 1990.

Because neither Frank nor Evelyn was covered by an employer retirement plan during 1990, they each figure their deduction using lines 1 through 3 of *IRA Worksheet 1* in their forms instructions package. Before completing their worksheets, they must each figure their earned income by completing a Schedule SE (see *Other Taxes*, later) and figuring their deductions for self-employment tax on line 25 (explained next). Frank's earned income is $25,215. This is his $20,940 wages plus $4,600 (the amount on his Schedule SE, Section A, line 3) minus $325 (his deduction for self-employment tax on line 25). Evelyn's earned income is $1,765. This is $1,900 (the amount on her Schedule SE, Section A, line 3) minus $135 (her deduction for self-employment tax on line 25).

Only Frank's worksheet is shown here.

IRA Worksheet 1

1. Enter IRA contributions you made for 1990, but **do not** enter more than $2,000	$ 2,000
2. Enter your wages and other earned income from Form 1040, minus any deduction you claim on Form 1040, lines 25 and 27. (Do not include your spouse's income and do not reduce your wages by losses from self-employment.)	25,215
3. Compare the amounts on lines 1 and 2. Enter the **smaller** of the two amounts on line 3. Enter on Form 1040, line 24a or 24b, whichever applies, the amount on line 3 you choose to deduct. If contributions were made to your nonworking spouse's IRA, go to line 4	$ 2,000

Both Frank and Evelyn can deduct their total contribution. They show Frank's $2,000 contribution on line 24a and Evelyn's $900 contribution on line 24b.

Deduction for self-employment tax (line 25). Both Frank and Evelyn owe self-employment tax for 1990. Before they figure the amount they can deduct, they each complete a Schedule SE and enter their combined self-employment tax, $919, on line 48. (See *Other Taxes*, later.) Then they enter one-half of that amount, $460, on line 25.

Adjusted gross income (line 31). Frank and Evelyn add the amounts from lines 24a, 24b, and 25, and enter $3,360 on line 30. Then they subtract line 30 from line 23. This amount, $33,350, is their adjusted gross income. They enter it on lines 31 and 32. This is the amount they use to figure the limit on their medical deduction and the limit on their miscellaneous deductions.

Standard Deduction

Frank and Evelyn must decide whether to take the standard deduction or itemize their actual deductions. Their standard deduction is $5,450. They will use this amount to compare with their itemized deductions when they complete Schedule A.

Itemized Deductions (Schedule A)

Frank and Evelyn figure their total itemized deductions by completing Schedule A.

Medical and dental expenses (lines 1–4, Schedule A). Frank and Evelyn paid $2,564 for medical and dental expenses not reimbursed by insurance. This includes $500 for Grace Smith (Evelyn's dependent mother) and $700 for Clara Jones (Frank's dependent sister). They enter $2,564 on line 1 and their adjusted gross income, $33,350, on line 2. On line 3, they enter $2,501, which is 7.5% of their adjusted gross income. They subtract line 3 from line 2 and enter the result, $63, on line 4.

Taxes you paid (lines 5–8, Schedule A). Frank and Evelyn next itemize the deductible taxes they paid during the year.

Frank had $1,301 state income tax withheld from his salary during 1990. They enter $1,301 on line 5.

Frank and Evelyn's tax year for real estate taxes on both their old and new homes is the calendar year, with payment due August 1. Their share of the tax on their old home, sold on May 2, was $630. Frank and Evelyn are considered to have paid their share of the real estate taxes on their old home even though they did not actually pay them to the tax authority.

They can claim only their share of the real estate taxes paid on their new home even though they paid the entire amount of $910. Their share of the taxes on the new home is $610.

Frank and Evelyn also paid $200 real estate taxes on a lakeside cottage they own.

Frank and Evelyn's real estate tax deduction is $1,440 ($630 + $610 + $200). They write this amount on line 6.

Frank and Evelyn show their total taxes paid, $2,741, on line 8.

Interest you paid (lines 9a–13, Schedule A). Frank and Evelyn made mortgage interest payments on both their old and new homes in 1990.

They received a Form 1098, *Mortgage Interest Statement*, from the financial institution that holds the mortgage on their new home, showing they paid $2,300 interest in 1990. This amount does not include the $400 deductible points they paid at closing. They did not receive a Form 1098 from the financial institution that held the mortgage on their old home. They enter $2,300 on line 9a and $400 on line 10.

From January to April they paid $140 interest on the mortgage on their old home. The settlement sheet for the sale of their old home showed a $50 penalty for prepayment of the mortgage and $20 interest for the period April 1 through May 1. They enter the total of these amounts, $210, on line 9b.

Frank and Evelyn also list $260 interest expense paid on their credit card and revolving charge accounts on line 12a. On line 12b they enter the deductible amount of this personal interest, $26 ($260 × .10). They add the amounts on lines 9a, 9b, 10, and 12b and

show their total deductible interest, $2,936, on line 13.

Gifts to charity (lines 14–17, Schedule A). Frank and Evelyn made cash charitable contributions of $778. They have receipts for all their contributions. Frank's share of the charitable contributions made by the Jones Brothers Partnership, as shown on his Schedule K–1 (Form 1065), is $50. Frank and Evelyn enter the total, $828, on line 14. They also enter this amount on line 17.

Casualty and theft losses (line 18, Schedule A). Frank and Evelyn did not have any casualty or theft losses, so they enter –0– on line 18.

Moving expenses (line 19, Schedule A, and Form 3903). Frank was transferred by his employer to a new job in another city. Frank and Evelyn decided to sell their home and buy a condominium apartment closer to Frank's new job. They kept their partnership interests at the old location because they can still carry out their duties by mail and telephone from their new home and do not have to commute. Frank's employer did not reimburse him for any of the moving expenses.

Frank and Evelyn make sure that the move meets the distance and time tests explained under *Requirements* in Chapter 27. The distance from their old home to Frank's new job is 91 miles farther than the distance from their old home to Frank's old job. Therefore, they meet the 35-mile distance test. Also, Frank expects to meet the 39-week full-time work test.

Their records show the following expenses for the move.

Paid to van company for moving furniture and household goods	$ 530
Car mileage to drive from old to new home—100 miles at 9¢ a mile	9
Motel room rent for one night on the day of arrival	61
Meals on the day of arrival	50
Pre-move mileage and motel expenses while looking for new home	500
Pre-move meals while looking for new home	200
Expenses of selling old home (realtor's commission and points)	9,000
Expenses of buying new home (settlement fees)	1,300

They figure their moving expense deduction on Form 3903, *Moving Expenses*, which they attach to their return.

Transportation of household goods (Section A, Part I of Form 3903). They show the total cost to move furniture and other household goods, $530, on line 4, Form 3903.

Expenses of moving from old to new home (Section B, Part I of Form 3903). The amount they show on line 5 is $70. This is the total of the car mileage and the motel room rent. They show the $50 they spent for meals on the day of their arrival on line 6. They enter $40 ($50 × .80) on line 7. They add the amounts on lines 5 and 7 and enter the total, $110, on line 8.

Pre-move househunting expenses (Section C, Part I of Form 3903). On line 9, Frank and Evelyn show their pre-move mileage and motel expenses of $500. Since they did not have any temporary quarters expenses, they leave line 10 blank. They enter their $200 of pre-move meal expenses on line 11. They show $160 ($200 × .80) on line 12. Frank and Evelyn add the amounts on lines 9 and 12 and enter the total, $660, on line 13.

Qualified real estate expenses (Section D, Part I of Form 3903). They enter the expenses of selling the old home, $9,000, on line 14, and check box ***a***. They enter the expense of buying the new home, $1,300, on line 15, and check box ***a***.

Dollar limitations (Part II of Form 3903). Frank and Evelyn enter the amount from line 13, $660, on line 16. This is less than the $1,500 limit, so they enter $660 on line 17. They add lines 14, 15, and 17 and enter the total, $10,960, on line 18. This total is more than the $3,000 limit, so they enter $3,000 on line 19. Because the $660 pre-move expenses are not deductible on any other schedule or form, they decide to use them and $2,340 of the selling expenses to make up the $3,000 limit. They use the remaining $6,660 of selling expenses and the $1,300 of expenses of buying the new home on Form 2119. (See *Sale of Your Home*, earlier.)

Frank and Evelyn add lines 4, 8, and 19 and enter the result, $3,640, on line 20 and on line 19, Schedule A.

Job expenses and miscellaneous deductions (lines 20–26, Schedule A). Frank and Evelyn list union dues of $350, subscriptions to trade magazines of $75, and small tools needed for Frank's job costing $335, and enter the total of these deductions, $760, on line 20. They do not have any expenses on line 21, so they also enter $760 on line 22.

They enter their adjusted gross income, $33,350, on line 23 and $667 ($33,350 × .02) on line 24. They subtract line 24 from line 22 and enter the result, $93, on line 25.

Other miscellaneous deductions (line 26). Frank and Evelyn do not have any miscellaneous deductions not subject to the 2% of adjusted gross income limit, so they enter –0– on line 26.

Total itemized deductions (line 27, Schedule A). Frank and Evelyn then add lines 4, 8, 13, 17, 19, and 25, and write the total of their itemized deductions, $10,301, on line 27. Since this total is larger than their standard deduction ($5,450), they enter $10,301 on line 34, Form 1040, and check the box for itemized deductions.

Tax Computation

Frank and Evelyn are now ready to figure their tax on lines 33a–40. None of the situations described on lines 33a, 33b, or 33c apply to them, so they leave the boxes on those lines blank. They subtract their itemized deductions on line 34 from their adjusted gross income on line 32 and enter $23,049 on line 35. Frank and Evelyn had already entered $12,300 on line 36 (see *Exemptions* under *Filing Status and Exemptions*, earlier), and now subtract this from line 35. The result, $10,749, is their taxable income. They enter it on line 37.

Frank and Evelyn must use the Tax Table to figure their tax because their taxable income is less than $50,000. They read down the income column until they find the line that includes their $10,749 taxable income. Next, they find the column heading that describes their filing status—married filing jointly—and read down the column. The amount shown where the income line and filing status column meet, $1,609, is their tax. They write it on line 38 and check the box marked *Tax Table*. Because Frank and Evelyn do not owe any additional taxes (line 39), they also write $1,609 on line 40.

Credits

Because Frank and Evelyn do not have any credits (lines 41–45), they enter zero on line 46 and $1,609 on line 47.

Other Taxes

Frank and Evelyn each have self-employment income over $400 and their total self-employment tax is the only "Other" tax they show on lines 48–53.

Self-employment tax (line 48 and Schedules SE). Frank and Evelyn each figure their self-employment tax on a separate Schedule SE. They can each use the short Schedule SE (Section A).

Evelyn enters her self-employment income of $1,900 on line 2 of Section A. She also enters $1,900 on line 3 and multiplies that amount by .9235. She enters the result, $1,755, on line 4. Since she had no wages subject to social security, she enters –0– on line 6. She subtracts line 6 from line 5, and enters $51,300 on line 7. On line 8 she enters $1,755, the smaller of line 4 or line 7. Evelyn's self-employment tax is $269 ($1,755 × .153), which she enters on line 10.

On a separate Schedule SE, Frank enters his self-employment income, $4,600, on lines 2 and 3 of Section A. He multiplies that amount by .9235 and enters the result, $4,248, on line 4. Frank's wages subject to social security tax were $20,940, which he enters on line 6. Frank subtracts the amount on line 6 from the amount on line 5 and enters the difference, $30,360, on line 7. Frank enters $4,248 on line 8, since it is the smaller of line 4 or line 7. Frank's self-employment tax is $650 ($4,248 × .153), which he enters on line 10.

They add Frank's self-employment tax and Evelyn's self-employment tax and enter the total, $919, on line 48, Form 1040. They attach both Schedules SE to their Form 1040.

Because they are not liable for any other taxes, they add line 48 to the amount on line 47. This total, $2,528, is Frank and Evelyn's total tax. They enter it on line 54.

Payments

Frank and Evelyn enter $2,155 on line 55. This is the amount of federal income tax withheld from Frank's salary, as shown on his Form W–2. On line 56, they write $500—the amount of estimated tax payments they made for 1990.

Frank and Evelyn enter on line 62, Form 1040, the total of these payments, $2,655.

Refund or Amount You Owe

Because line 62 is more than line 54, Frank and Evelyn have overpaid their taxes. They write the amount of the overpayment, $127, on line 63. Because they do not want this amount credited to their 1991 estimated tax, they also enter $127 on line 64. This is the amount of their refund.

They check their return to make sure they have completed all the items and the schedules called for and that the schedules and forms are attached in attachment sequence number order. The attachment sequence number is just below the year in the upper right corner of each schedule or form. They remove the mailing label from the forms instructions package and put it in the address portion on the top of Form 1040. Both Frank and Evelyn sign the return and date it, because it is a joint return. Also, they enter their occupations in the space provided next to the signature lines.

Frank and Evelyn make a copy of the return to keep for their records. Then they use the envelope that came with their forms package to mail the return to the Service Center for their area.

Filled-In Form 1040 **If you need more information, turn to the page shown in the circle.**

Form 1040 U.S. Individual Income Tax Return 1990

Department of the Treasury—Internal Revenue Service

For the year Jan.–Dec. 31, 1990, or other tax year beginning 1990, ending 19 OMB No 1545-0074

Label (See Instructions on page 8.) Use IRS label. Otherwise, please print or type.

Your first name and initial / Last name

CAR-RT SORT**CR01
JT 516-00-1492 575-00-1776 S29 30
FRANK R & EVELYN D JONES
3807 MILLWAY 203
LAKECITY NY 14010

Apt. no.

(9) Your social security number

Spouse's social security number

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

(9) **Presidential Election Campaign** (See page 9.) Do you want $1 to go to this fund? ✓ Yes No
If joint return, does your spouse want $1 to go to this fund? ✓ Yes No
Note: Checking "Yes" will not change your tax or reduce your refund.

(15) **Filing Status** Check only one box.

1 ☐ Single. (See page 10 to find out if you can file as head of household.)
2 ✓ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See page 10.) If the qualifying person is your child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶19). (See page 10.)

(18) **Exemptions** (See Instructions on page 10.)

6a ☑ Yourself If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. But be sure to check the box on line 33b on page 2
b ☑ Spouse

No. of boxes checked on 6a and 6b: 2

c Dependents:

(1) Name (first, initial, and last name)	(2) Check if under age 2	(3) If age 2 or older, dependent's social security number	(4) Dependent's relationship to you	(5) No. of months lived in your home in 1990
Marie A. Jones		123 00 4567	Daughter	12
James R. Jones		234 00 5678	Son	12
Grace L. Smith		345 00 6789	Mother	12
Clara D. Jones		456 00 7890	Sister	0*

No. of your children on 6c who:
• lived with you: 2
• didn't live with you due to divorce or separation (see page 11):
No. of other dependents on 6c: 2

If more than 6 dependents, see Instructions on page 11.

d ☐ If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶
e Total number of exemptions claimed (39) (47)

Add numbers entered on lines above ▶ 6

Income Attach Copy B of your Forms W-2, W-2G, and W-2P here (56) (57) (79)

If you do not have a W-2, see page 8. (108) (90) (58)

Attach check or money order on top of any Form W-2, W-2G, or W-2P. (106) (88) (61)

7	Wages, salaries, tips, etc. (attach Form(s) W-2) (48)		7	20,940
8a	Taxable interest income (also attach Schedule B if over $400)		8a	430
b	Tax-exempt interest income (see page 13). DON'T include on line 8a	8b 500		
9	Dividend income (also attach Schedule B if over $400)		9	680
10	Taxable refunds of state and local income taxes, if any, from worksheet on page 14		10	110
11	Alimony received		11	
12	Business income or (loss) (attach Schedule C)		12	
13	Capital gain or (loss) (attach Schedule D)		13	1,900
14	Capital gain distributions not reported on line 13 (see page 14)		14	
15	Other gains or (losses) (attach Form 4797)		15	
16a	Total IRA distributions (80)	16a (78)	16b Taxable amount (see page 14)	16b
17a	Total pensions and annuities	17a 2,550	17b Taxable amount (see page 14)	17b 2,100
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)		18	10,500
19	Farm income or (loss) (attach Schedule F) (79)		19	
20	Unemployment compensation (insurance) (see page 16) (40)		20	
21a	Social security benefits (74)	21a	21b Taxable amount (see page 16)	21b
22	Other income (list type and amount—see page 16) (77) Photography Contest Prize		22	50
23	Add the amounts shown in the far right column for lines 7 through 22. This is your total income ▶		23	36,710

Adjustments to Income (See Instructions on page 17.) (101) (120) (115) (108)

24a	Your IRA deduction, from applicable worksheet on page 17 or 18	24a 2,000		
b	Spouse's IRA deduction, from applicable worksheet on page 17 or 18	24b 900		
25	One-half of self-employment tax (see page 18)	25 460		
26	Self-employed health insurance deduction, from worksheet on page 18	26		
27	Keogh retirement plan and self-employed SEP deduction	27		
28	Penalty on early withdrawal of savings (57)	28		
29	Alimony paid. Recipient's SSN ▶	29		
30	Add lines 24a through 29. These are your total adjustments ▶		30	3,360

Adjusted Gross Income (101)

31	Subtract line 30 from line 23. This is your adjusted gross income. If this amount is less than $20,264 and a child lived with you, see page 23 to find out if you can claim the "Earned Income Credit" on line 57 ▶	31	33,350

* Forms 2210 Attached (Not shown)

Filled-In Form 1C40

If you need more information, turn to the page shown in the circle.

Form 1040 (1990) Page 2

	32	Amount from line 31 (adjusted gross income)		32	33,350
Tax Computation (112)	33a	Check if: ☐ **You** were 65 or older ☐ Blind. ☐ **Spouse** was 65 or older ☐ Blind. Add the number of boxes checked above and enter the total here ▶ 33a			
	b	If your parent (or someone else) can claim you as a dependent, check here ▶ 33b ☐			
If you want IRS to figure your tax, see Instructions on page 19	c	If you are married filing a separate return and your spouse itemizes deductions, or you are a dual-status alien, see page 19 and check here ▶ 33c ☐			
(114)	34	Enter the **larger** of: • Your **standard deduction** (from the chart (or worksheet) on page 20 that applies to you), **OR** • Your **itemized deductions** (from Schedule A, line 27). If you itemize, attach Schedule A and check here (113) ▶ ☑		34	10,301
	35	Subtract line 34 from line 32		35	23,049
	36	Multiply $2,050 by the total number of exemptions claimed on line 6e		36	12,300
(161)	37	**Taxable income.** Subtract line 36 from line 35. (If line 36 is more than line 35, enter -0-.)		37	10,749
	38	Enter tax. Check if from: a ☑ Tax Table, b ☐ Tax Rate Schedules, or c ☐ Form 8615 (see page 21) (If any is from Form(s) 8814, enter that amount here ▶ d _____.)		38	1,609
	39	Additional taxes (see page 21). Check if from: a ☐ Form 4970 b ☐ Form 4972		39	
	40	Add lines 38 and 39 ▶		40	1,609
(169)	41	Credit for child and dependent care expenses *(attach Form 2441)*	41		
(176)	42	Credit for the elderly or the disabled *(attach Schedule R)*	42		
Credits	43	Foreign tax credit *(attach Form 1116)*	43		
(See Instructions on page 21.)	44	General business credit. Check if from: a ☐ Form 3800 or b ☐ Form (specify) _____	44		
	45	Credit for prior year minimum tax *(attach Form 8801)*	45		
	46	Add lines 41 through 45		46	0
	47	Subtract line 46 from line 40. (If line 46 is more than line 40, enter -0-) ▶		47	1,609
(7)	48	Self-employment tax *(attach Schedule SE)*		48	919
Other Taxes (182)	49	Alternative minimum tax *(attach Form 6251)*		49	
	50	Recapture taxes (see page 22). Check if from: a ☐ Form 4255 b ☐ Form 8611		50	
(48)	51	Social security tax on tip income not reported to employer *(attach Form 4137)*		51	
(107)	52	Tax on an IRA or a qualified retirement plan *(attach Form 5329)*		52	
(162)	53	Advance earned income credit payments from Form W-2		53	
	54	Add lines 47 through 53. This is your **total tax** ▶		54	2,528
(36)	55	Federal income tax withheld (**If any is from Form(s) 1099, check** ▶ ☐)	55	2,155	
(181)	56	1990 estimated tax payments and amount applied from 1989 return	56	500	
Payments (11)	57	**Earned income credit** (see page 23)	57		
Attach Forms W-2, W-2G, and W-2P to front.	58	Amount paid with Form 4868 (extension request)	58		
	59	Excess social security tax and RRTA tax withheld (see page 24)	59		
(183)	60	Credit for Federal tax on fuels *(attach Form 4136)*	60		
	61	Regulated investment company credit *(attach Form 2439)*	61		
	62	Add lines 55 through 61. These are your **total payments** ▶		62	2,655
(12)	63	If line 62 is more than line 54, enter amount **OVERPAID** ▶		63	127
	64	Amount of line 63 to be **REFUNDED TO YOU** ▶		64	127
Refund or Amount You Owe	65	Amount of line 63 to be **APPLIED TO YOUR 1991 ESTIMATED TAX** ▶	65		
(35)	66	If line 54 is more than line 62, enter **AMOUNT YOU OWE.** Attach check or money order for full amount payable to "Internal Revenue Service." Write your name, address, social security number, daytime phone number, and "1990 Form 1040" on it. (12)		66	
(37)	67	Estimated tax penalty (see page 25)	67		

Sign Here (10)

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Keep a copy of this return for your records.

	Date	Your occupation
Your signature: Frank R. Jones	3/29/91	Electrician
Spouse's signature (if joint return, BOTH must sign): Evelyn D. Jones	3/29/91	Spouse's occupation: Travel Agent

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed ☐ / Preparer's social security no.
Firm's name (or yours if self-employed) and address		E.I. No. / ZIP code

Filled-In Schedule A

If you need more information, turn to the page shown in the circle.

SCHEDULES A&B (Form 1040)

Department of the Treasury Internal Revenue Service

Schedule A—Itemized Deductions

(Schedule B is on back)

► Attach to Form 1040. ► See Instructions for Schedules A and B (Form 1040).

OMB No 1545-0074

1990

Attachment Sequence No. 07

Name(s) shown on Form 1040: Frank R. and Evelyn D. Jones

Your social security number: 516 00 1492

Medical and Dental Expenses (115)		Caution: *Do not include expenses reimbursed or paid by others.*			
	1	Medical and dental expenses. (See page 27 of the Instructions.)	1	2,564	
	2	Enter amount from Form 1040, line 32	2	33,350	
	3	Multiply the amount on line 2 by 7.5% (.075). Enter the result	3	2,501	
	4	Subtract line 3 from line 1. Enter the result. If less than zero, enter -0- ►			4 63
Taxes You Paid (118) (See Instructions on page 27.)	5	State and local income taxes	5	1,301	
	6	Real estate taxes	6	1,440	
	7	Other taxes. (List—include personal property taxes.) ►	7		
	8	Add the amounts on lines 5 through 7. Enter the total ►			8 2,741
Interest You Paid (121) (See Instructions on page 27.)	9a	Deductible home mortgage interest paid to financial institutions and reported to you on Form 1098. Report deductible points on line 10	9a	2,300	
	b	Other deductible home mortgage interest. (If paid to an individual, show that person's name and address.) ►	9b	210	
	10	Deductible points. (See Instructions for special rules.)	10	400	
	11	Deductible investment interest (attach Form 4952 if required). (See page 28.)	11		
	12a	Personal interest you paid. (See page 28.) 12a 260			
	b	Multiply the amount on line 12a by 10% (.10). Enter the result	12b	26	
	13	Add the amounts on lines 9a through 11, and 12b. Enter the total ►			13 2,936
Gifts to Charity (125) (See Instructions on page 29.)		Caution: *If you made a charitable contribution and received a benefit in return, see page 29 of the Instructions.*			
	14	Contributions by cash or check	14	828	
	15	Other than cash or check. (You **MUST** attach Form 8283 if over $500.)	15		
	16	Carryover from prior year	16		
	17	Add the amounts on lines 14 through 16. Enter the total ►			17 828
Casualty and Theft Losses (128)	18	Casualty or theft loss(es) (attach Form 4684). (See page 29 of the Instructions.) ►			18 -0-
Moving Expenses (133)	19	Moving expenses (attach Form 3903 or 3903F). (See page 30 of the Instructions.) ►			19 3,640
Job Expenses and Most Other Miscellaneous Deductions (152) (See Instructions on page 30 for expenses to deduct here.) (155) (136)	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. (You **MUST** attach Form 2106 if required. See Instructions.) ► Union Dues-350 Trade magazines-75 Small tools-335	20	760	
	21	Other expenses (investment, tax preparation, safe deposit box, etc.). List type and amount ►	21		
	22	Add the amounts on lines 20 and 21. Enter the total	22	760	
	23	Enter amount from Form 1040, line 32. 23 33,350			
	24	Multiply the amount on line 23 by 2% (.02). Enter the result	24	667	
	25	Subtract line 24 from line 22. Enter the result. If less than zero, enter -0- ►			25 93
Other Miscellaneous Deductions	26	Other (from list on page 30 of Instructions). List type and amount ►			26 -0-
Total Itemized Deductions (161)	27	Add the amounts on lines 4, 8, 13, 17, 18, 19, 25, and 26. Enter the total here. Then enter on Form 1040, line 34, the **LARGER** of this total or your standard deduction from page 20 of the Instructions ►			27 10,301

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule A (Form 1040) 1990

Filled-in Schedule B **If you need more information, turn to the page shown in the circle.**

Schedules A&B (Form 1040) 1990 OMB No 1545-0074 Page 2

Name(s) shown on Form 1040. (Do not enter name and social security number if shown on other side.) | Your social security number

Schedule B—Interest and Dividend Income

Attachment Sequence No. 08

Part I Interest Income (48)

(See instructions on pages 13 and 30.)

If you received more than $400 in taxable interest income, or you are claiming the exclusion of interest from series EE U.S. savings bonds issued after 1989 (see page 31), you must complete Part I. List ALL interest received in Part I. If you received more than $400 in taxable interest income, you must also complete Part III. If you received, as a nominee, interest that actually belongs to another person, or you received or paid accrued interest on securities transferred between interest payment dates, see page 31.

Interest Income		Amount
1 Interest income. (List name of payer—if any interest income is from seller-financed mortgages, see Instructions and list that interest first.) ▶		
National Bank		330
First Savings and Loan		100
	1	
2 Add the amounts on line 1. Enter the total	2	430
3 Enter the excludable savings bond interest, if any, from Form 8815, line 14. Attach Form 8815 to Form 1040	3	
4 Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶	4	430

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement, from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

Part II Dividend Income (57)

(See Instructions on pages 13 and 31.)

If you received more than $400 in gross dividends and/or other distributions on stock, you must complete Parts II and III. If you received, as a nominee, dividends that actually belong to another person, see page 31.

Dividend Income		Amount
5 Dividend income. (List name of payer—include on this line capital gain distributions, nontaxable distributions, etc.) ▶		
Acme Publishing Company		210
Zepco, Inc.		310
Equity Money Market Fund		50
Tiger Mutual Fund		60
Equity Brokers	5	40
Jones Brothers Partnership		80
6 Add the amounts on line 5. Enter the total	6	750
7 Capital gain distributions. Enter here and on Schedule D* 7 60		
8 Nontaxable distributions. (See the Inst. for Form 1040, line 9.) 8 10		
9 Add the amounts on lines 7 and 8. Enter the total	9	70
10 Subtract line 9 from line 6. Enter the result here and on Form 1040, line 9 ▶	10	680

Note: If you received a Form 1099-DIV, or substitute statement, from a brokerage firm, list the firm's name as the payer and enter the total dividends shown on that form.

**If you received capital gain distributions but do not need Schedule D to report any other gains or losses, see the Instructions for Form 1040, lines 13 and 14.*

Part III Foreign Accounts and Foreign Trusts (18)

(See Instructions on page 31.)

If you received more than $400 of interest or dividends, OR if you had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must answer both questions in Part III.

	Yes	No
11a At any time during 1990, did you have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? (See page 31 of the Instructions for exceptions and filing requirements for Form TD F 90-22.1.)		✓
b If "Yes," enter the name of the foreign country ▶		
12 Were you the grantor of, or transferor to, a foreign trust that existed during 1990, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 926		✓

For Paperwork Reduction Act Notice, see Form 1040 Instructions. Schedule B (Form 1040) 1990

Filled-in Schedule D

If you need more information, turn to the page shown in the circle.

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses (98)

(And Reconciliation of Forms 1099-B for Bartering Transactions)

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ For more space to list transactions for lines 2a and 9a, get Schedule D-1 (Form 1040).

OMB No. 1545-0074

1990

Attachment Sequence No. 12A

Name(s) shown on Form 1040: Frank R. and Evelyn D. Jones

Your social security number: 516 00 1492

1 (98) Enter the total sales of stocks, bonds, other securities, and real estate transactions reported to you for 1990 on Forms 1099-B and 1099-S (or on substitute statements). If this total is not the same as the total of lines 2c and 9c, column (d), attach a statement explaining the difference. (Do not include on this line amounts from Form 1099-S if you reported them on another form or schedule.) **See Instructions for line 1** . . . . 1 — 7,400

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see Instructions)	(e) Cost or other basis (see Instructions)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
2a Stocks, Bonds, Other Securities, and Real Estate. Include Form 1099-B and 1099-S Transactions. See Instructions.						
100 sh. A Co.	12-7-89	5-4-90	800	1,100	300	
50 sh. B Co.	1-4-90	3-2-90	600	500		100
2b Amounts from Schedule D-1, line 2b (attach Schedule D-1)						
2c Total of All Sales Price Amounts. Add column (d) of lines 2a and 2b ▶ 2c			1,400			
2d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 2a.)						
Bad debt - John Green - Schedule attached* (92)					200	

(93) 3 Short-term gain from sale or exchange of your home from Form 2119, line 10 or 14c	3			
4 Short-term gain from installment sales from Form 6252, line 22 or 30	4			
(99) 5 Net short-term gain or (loss) from partnerships, S corporations, and fiduciaries	5			
6 Short-term capital loss carryover from 1989 Schedule D, line 29	6	500		
(98) 7 Add lines 2a, 2b, 2d, and 3 through 6, in columns (f) and (g)	7	(1,000)		100
8 **Net short-term gain or (loss).** Combine columns (f) and (g) of line 7			8	(900)

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

9a Stocks, Bonds, Other Securities, and Real Estate. Include Form 1099-B and 1099-S Transactions. See Instructions.						
300 sh. XYZ Co.	2-10-84	5-4-90	6,000	3,000		3,000
Bond D. Co. (91)	1-29-88	Worthless		560	560	
9b Amounts from Schedule D-1, line 9b (attach Schedule D-1)						
9c Total of All Sales Price Amounts. Add column (d) of lines 9a and 9b ▶ 9c			6,000			
9d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 9a.)						

(93) 10 Long-term gain from sale or exchange of your home from Form 2119, line 10 or 14c	10		
11 Long-term gain from installment sales from Form 6252, line 22 or 30	11		
(58) 12 Net long-term gain or (loss) from partnerships, S corporations, and fiduciaries	12		300
13 Capital gain distributions	13		60
(99) 14 Gain from Form 4797, line 7 or 9	14		
15 Long-term capital loss carryover from 1989 Schedule D, line 36	15		
16 Add lines 9a, 9b, 9d, and 10 through 15, in columns (f) and (g)	16	(560)	3,360
17 **Net long-term gain or (loss).** Combine columns (f) and (g) of line 16		17	2,800

For Paperwork Reduction Act Notice, see Form 1040 Instructions. Schedule D (Form 1040) 1990

* (Not shown)

Filled-In

Schedule D **If you need more information, turn to the page shown in the circle.**

Schedule D (Form 1040) 1990 Attachment Sequence No. 12A Page 2

Name(s) shown on Form 1040 (Do not enter name and social security number if shown on other side.) Your social security number

Part III Summary of Parts I and II

18	Combine lines 8 and 17, and enter the net gain or (loss) here. If the result is a gain, **stop here** and also enter the gain on Form 1040, line 13	18	1,900
19	If line 18 is a (loss), enter here and as a (loss) on Form 1040, line 13, the **smaller** of:		
99 a	The (loss) on line 18; **or**		
b	($3,000) or, if married filing a separate return, ($1,500)	19	( )
	Note: *When figuring whether line 19a or 19b is* ***smaller****, treat both numbers as if they were positive.*		
	Go on to Part IV if the loss on line 18 is more than $3,000 ($1,500, if married filing a separate return), OR if taxable income on Form 1040, line 37, is zero.		

Part IV Capital Loss Carryovers from 1990 to 1991

Section A.—Carryover Limit

20	Enter taxable income from Form 1040, line 37. **(If Form 1040, line 37 is zero, see instructions for amount to enter.)**	20	
	Note: *For lines 21 through 36, enter all amounts as positive numbers.*		
21	Enter the loss on line 19	21	
22	Enter the amount on Form 1040, line 36	22	
23	Combine lines 20, 21, and 22. If zero or less, enter -0-	23	
24	**Carryover Limit.** Enter the **smaller** of line 21 or line 23	24	

Section B.—Short-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on both line 8 and line 19. Otherwise, go on to Section C.)

25	Enter the loss on line 8			25	
26	Enter the gain, if any, on line 17	26			
27	Enter the amount on line 24	27			
28	Add lines 26 and 27			28	
29	**Short-term capital loss carryover to 1991.** Subtract line 28 from line 25. If zero or less, enter -0-			29	

Section C.—Long-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on both line 17 and line 19.)

30	Enter the loss on line 17			30	
31	Enter the gain, if any, on line 8			31	
32	Enter the amount on line 24	32			
33	Enter the amount, if any, on line 25	33			
34	Subtract line 33 from line 32. If zero or less, enter -0-			34	
35	Add lines 31 and 34			35	
36	**Long-term capital loss carryover to 1991.** Subtract line 35 from line 30. If zero or less, enter -0-			36	

Part V Election Not to Use the Installment Method (Complete this part only if you elect out of the installment method and report a note or other obligation at less than full face value.)

37	Check here if you elect out of the installment method	▶ ☐
38	Enter the face amount of the note or other obligation	▶
39	Enter the percentage of valuation of the note or other obligation	▶

Part VI Reconciliation of Forms 1099-B for Bartering Transactions

(Complete this part if you received one or more Forms 1099-B or substitute statements reporting bartering income.)

			Amount of bartering income from Form 1099-B or substitute statement reported on form or schedule
40	Form 1040, line 22	40	
41	Schedule C (Form 1040)	41	
42	Schedule D (Form 1040)	42	
43	Schedule E (Form 1040)	43	
44	Schedule F (Form 1040)	44	
45	Other form or schedule (identify) (if nontaxable, indicate reason—attach additional sheets if necessary):	45	
46	Total (add lines 40 through 45)	46	
	Note: *The amount on line 46 should be the same as the total bartering income on all Forms 1099-B and substitute statements received for bartering transactions.*		

Filled-in Schedule E If you need more information, turn to the page shown in the circle.

SCHEDULE E (Form 1040)

Department of the Treasury
Internal Revenue Service

Supplemental Income and Loss

(From rents, royalties, partnerships, estates, trusts, REMICs, etc.)

(61) ▶ Attach to Form 1040 or Form 1041.
▶ See Instructions for Schedule E (Form 1040).

OMB No. 1545-0074

1990

Attachment Sequence No. 13

Name(s) shown on return: Frank R. and Evelyn D. Jones (80)

Your social security number: 516 00 1492

Part I Income or Loss From Rentals and Royalties Note: *Report farm rental income or loss from Form 4835 on page 2, line 39.*

1 Show the kind and location of each rental property:
A Brick Store, 410 Main St., Hometown, NY
B Unimproved Land, Hometown, N.Y.
C

(63)

2 For each rental property listed on line 1, did you or your family use it for personal purposes for more than the greater of 14 days or 10% of the total days rented at fair rental value during the tax year? (See Instructions.)

	Yes	No
A		✓
B		✓
C		

Rental and Royalty Income:		Properties A	Properties B	Properties C	D Totals (Add columns A, B, and C)
3 Rents received	3	8,400	720		9,120
4 Royalties received	4				
Rental and Royalty Expenses:					
5 Advertising	5				
6 Auto and travel	6				
7 Cleaning and maintenance	7				
8 Commissions	8				
9 Insurance	9	300			
10 Legal and other professional fees	10				
11 Mortgage interest paid to banks, etc. (see Instructions)	11	3,100			3,100
12 Other interest	12				
13 Repairs	13	742			
14 Supplies	14				
15 Taxes	15	1,200	100		
16 Utilities	16				
17 Wages and salaries	17				
18 Other (list) ▶ Transportation - 300 miles	18	78			
19 Add lines 5 through 18	19	5,420	100		5,520
20 Depreciation expense or depletion (see Instructions)	20	1,000			1,000
21 Total expenses. Add lines 19 and 20	21	6,420	100		
22 Income or (loss) from rental or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see Instructions to find out if you must file **Form 6198**	22	1,980	620		
23 Deductible rental loss. **Caution:** *Your rental loss on line 22 may be limited. See Instructions to find out if you must file Form 8582*	23	( )	( )	( )	
24 **Income.** Add rental and royalty income from line 22. Enter the total income here	24				2,600
25 **Losses.** Add royalty losses from line 22 and rental losses from line 23. Enter the total losses here	25				( )
26 Total rental and royalty income or (loss). Combine amounts on lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 39 on page 2 do not apply to you, enter the amount from line 26 on Form 1040, line 18. Otherwise, include the amount from line 26 in the total on line 40 on page 2.	26				2,600

For Paperwork Reduction Act Notice, see Form 1040 Instructions. Schedule E (Form 1040) 1990

Filled-In

Schedule E **If you need more information, turn to the page shown in the circle.**

Schedule E (Form 1040) 1990 Attachment Sequence No. 13 Page 2

Name(s) shown on return. (Do not enter name and social security number if shown on other side.) (79) Your social security number

Note: *If you report amounts from farming or fishing on Schedule E, you must include your gross income from those activities on line 41 below.*

Part II Income or Loss From Partnerships and S Corporations

If you report a loss from an at-risk activity, you MUST check either column (e) or (f) of line 27 to describe your investment in the activity. See Instructions. If you check column (f), you must attach **Form 6198.**

27	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	Investment At Risk? (e) All is at risk	(f) Some is not at risk
A	Jones Brothers Partnership	P		10-1987654	✓	
B	Gateway Travel Agency	P		10-5431234	✓	
C						
D						
E						

	Passive Income and Loss		Nonpassive Income and Loss		
	(g) Passive loss allowed (Attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss from Schedule K-1	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
A					4,600
B					1,900
C					
D					
E					
28a Totals					6,500
b Totals					

29	Add amounts in columns (h) and (k) of line 28a. Enter the total income here	29	6,500
30	Add amounts in columns (g), (i), and (j) of line 28b. Enter the total here	30	( )
31	Total partnership and S corporation income or (loss). Combine amounts on lines 29 and 30. Enter the result here and include in the total on line 40 below	31	6,500

Part III Income or Loss From Estates and Trusts

32	(78) (a) Name	(b) Employer identification number
A	J.B. Jones Trust	10-3169222
B		
C		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (Attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A		1,400		
B				
C				
33a Totals		1,400		
b Totals				

34	Add amounts in columns (d) and (f) of line 33a. Enter the total income here	34	1,400
35	Add amounts in columns (c) and (e) of line 33b. Enter the total here	35	( )
36	Total estate and trust income or (loss). Combine amounts on lines 34 and 35. Enter the result here and include in the total on line 40 below	36	1,400

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

37	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see Instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

38	Combine amounts in columns (d) and (e) only. Enter the result here and include in the total on line 40 below	38	

Part V Summary

39	Net farm rental income or (loss) from **Form 4835**. (Also complete line 41 below.)	39	
40	TOTAL income or (loss). Combine amounts on lines 26, 31, 36, 38, and 39. Enter the result here and on Form 1040, line 18 ▶	40	10,500
41	**Reconciliation of Farming and Fishing Income:** Enter your **gross** farming and fishing income reported in Parts II and III, and on line 39 (see Instructions)	41	

Filled-in Schedule SE *If you need more information, turn to the page shown in the circle.*

SCHEDULE SE (Form 1040)
Department of the Treasury
Internal Revenue Service

(7)—Social Security Self-Employment Tax

▶ See Instructions for Schedule SE (Form 1040).
▶ Attach to Form 1040.

OMB No. 1545-0074
1990
Attachment Sequence No. 17

Name of person with **self-employment** income (as shown on Form 1040): Frank R. Jones

Social security number of person with **self-employment** income ▶ 516 00 1492

Who Must File Schedule SE

You must file Schedule SE if:

- Your net earnings from self-employment were $400 or more; **OR**
- You were an employee of an electing church or church-controlled organization that paid you wages (church employee income) of $100 or more;

AND

- Your wages (subject to social security or railroad retirement tax) were less than $51,300.

Exception: If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner, AND you filed **Form 4361** and received IRS approval not to be taxed on those earnings, DO NOT file Schedule SE. Instead, write "Exempt–Form 4361" on Form 1040, line 48.

For more information about Schedule SE, see the Instructions.

Note: *Most people can use the short Schedule SE on this page. But, you may have to use the longer Schedule SE on the back.*

Who MUST Use the Long Schedule SE (Section B)

You must use Section B if ANY of the following apply:

- You elect the "optional method" to figure your self-employment tax (see Section B, Part II, and the Instructions);
- You are a minister, member of a religious order, or Christian Science practitioner and you received IRS approval (from **Form 4361**) not to be taxed on your earnings from these sources, but you owe self-employment tax on other earnings;
- You had church employee income of $100 or more that was reported to you on Form W-2;
- You had tip income that is subject to social security tax, but you did not report those tips to your employer; OR
- You were a government employee with wages subject ONLY to the 1.45% Medicare part of the social security tax (Medicare qualified government wages) AND the total of **all** of your wages (subject to social security, railroad retirement, or the 1.45% Medicare tax) plus **all** your earnings subject to self-employment tax is **more** than $51,300.

Section A—Short Schedule SE (Read above to see if you must use the long Schedule SE on the back (Section B).)

1	Net farm profit or (loss) from Schedule F (Form 1040), line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1	
2	Net profit or (loss) from Schedule C (Form 1040), line 29, and Schedule K-1 (Form 1065), line 15a (other than farming). See Instructions for other income to report.	2	4,600
3	Combine lines 1 and 2. Enter the result	3	4,600
4	Multiply line 3 by .9235. Enter the result. If the result is less than $400, **do not** file this schedule; you **do not** owe self-employment tax. ▶	4	4,248
5	Maximum amount of combined wages and self-employment earnings subject to social security or railroad retirement (tier 1) tax for 1990	5	$51,300 00
6	Total social security wages and tips (from Form(s) W-2) and railroad retirement compensation (tier 1). **Do not** include Medicare qualified government wages on this line	6	20,940
7	Subtract line 6 from line 5. Enter the result. If the result is zero or less, **do not** file this schedule; you **do not** owe self-employment tax. ▶	7	30,360
8	Enter the **smaller** of line 4 or line 7	8	4,248
9	Rate of tax	9	x.153
10	**Self-employment tax.** If line 8 is $51,300, enter $7,848.90. Otherwise, multiply the amount on line 8 by the decimal amount on line 9 and enter the result. Also enter this amount on Form 1040, line 48	10	650

(120) **Note:** *Also enter one-half of this amount on Form 1040, line 25.*

For Paperwork Reduction Act Notice, see Form 1040 Instructions. **Schedule SE (Form 1040) 1990**

Filled-in Schedule SE If you need more information, turn to the page shown in the circle.

SCHEDULE SE (Form 1040)

Department of the Treasury
Internal Revenue Service

(7) Social Security Self-Employment Tax

▶ See Instructions for Schedule SE (Form 1040).

▶ Attach to Form 1040.

OMB No. 1545-0074

1990

Attachment Sequence No. 17

Name of person with **self-employment** income (as shown on Form 1040): Evelyn D. Jones

Social security number of person with **self-employment** income ▶ 575 00 1776

Who Must File Schedule SE

You must file Schedule SE if:

- Your net earnings from self-employment were $400 or more; **OR**
- You were an employee of an electing church or church-controlled organization that paid you wages (church employee income) of $100 or more;

AND

- Your wages (subject to social security or railroad retirement tax) were less than $51,300.

Exception: If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner, AND you filed **Form 4361** and received IRS approval not to be taxed on those earnings, DO NOT file Schedule SE. Instead, write "Exempt–Form 4361" on Form 1040, line 48.

For more information about Schedule SE, see the Instructions.

Note: *Most people can use the short Schedule SE on this page. But, you may have to use the longer Schedule SE on the back.*

Who MUST Use the Long Schedule SE (Section B)

You must use Section B if ANY of the following apply:

- You elect the "optional method" to figure your self-employment tax (see Section B, Part II, and the Instructions);
- You are a minister, member of a religious order, or Christian Science practitioner and you received IRS approval (from **Form 4361**) not to be taxed on your earnings from these sources, but you owe self-employment tax on other earnings;
- You had church employee income of $100 or more that was reported to you on Form W-2;
- You had tip income that is subject to social security tax, but you did not report those tips to your employer; OR
- You were a government employee with wages subject ONLY to the 1.45% Medicare part of the social security tax (Medicare qualified government wages) AND the total of **all** of your wages (subject to social security, railroad retirement, or the 1.45% Medicare tax) plus **all** your earnings subject to self-employment tax is **more** than $51,300.

Section A—Short Schedule SE (Read above to see if you must use the long Schedule SE on the back (Section B).)

1	Net farm profit or (loss) from Schedule F (Form 1040), line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1	
2	Net profit or (loss) from Schedule C (Form 1040), line 29, and Schedule K-1 (Form 1065), line 15a (other than farming). See Instructions for other income to report.	2	1,900
3	Combine lines 1 and 2. Enter the result	3	1,900
4	Multiply line 3 by .9235. Enter the result. If the result is less than $400, **do not** file this schedule; you **do not** owe self-employment tax. ▶	4	1,755
5	Maximum amount of combined wages and self-employment earnings subject to social security or railroad retirement (tier 1) tax for 1990	5	$51,300 00
6	Total social security wages and tips (from Form(s) W-2) and railroad retirement compensation (tier 1). **Do not** include Medicare qualified government wages on this line	6	0
7	Subtract line 6 from line 5. Enter the result. If the result is zero or less, **do not** file this schedule; you **do not** owe self-employment tax. ▶	7	51,300
8	Enter the **smaller** of line 4 or line 7	8	1,755
9	Rate of tax	9	x.153
10	**Self-employment tax.** If line 8 is $51,300, enter $7,848.90. Otherwise, multiply the amount on line 8 by the decimal amount on line 9 and enter the result. Also enter this amount on Form 1040, line 48	10	269

(120) **Note:** *Also enter one-half of this amount on Form 1040, line 25.*

For Paperwork Reduction Act Notice, see Form 1040 Instructions. **Schedule SE (Form 1040) 1990**

Filled-in Form 2119 If you need more information, turn to the page shown in the circle.

Form **2119** — (93) **Sale of Your Home**

Department of the Treasury Internal Revenue Service

▶ Attach to Form 1040 for year of sale.

▶ See Separate Instructions. ▶ Please print or type.

OMB No. 1545-0072

1990

Attachment Sequence No. 20

Your first name and initial (If joint, also give spouse's name and initial.)	Last name	Your social security number
Frank R. and Evelyn D.	Jones	516 00 1492

Fill In Your Address Only If You Are Filing This Form by Itself and Not With Your Tax Return

Present address (no., street, and apt. no., rural route, or P.O. box no. if mail is not delivered to street address): 3807 Mill Way

Spouse's social security number: 575 00 1776

City, town or post office, state, and ZIP code: Lakecity, NY 14010

Part I General Information

1a	Date your former main home was sold (month, day, year) ▶		5 / 2 / 90
b	Enter the face amount of any mortgage, note (e.g., second trust), or other financial instrument on which you will receive periodic payments of principal or interest from this sale (see Instructions) ▶	1b	
2	Have you bought or built a new main home?		☑ Yes ☐ No
3	Is or was any part of either main home rented out or used for business? (If "Yes," see Instructions.)		☐ Yes ☑ No

Part II Gain on Sale *(Do not include amounts you deduct as moving expenses.)*

4	Selling price of home. (Do not include personal property items that you sold with your home.)	4	160,000
5	Expense of sale. (Include sales commissions, advertising, legal, etc.)	5	6,660
6	Amount realized. Subtract line 5 from line 4	6	153,340
7	Basis of home sold. (See Instructions.)	7	25,000
8a	**Gain on sale.** Subtract line 7 from line 6	8a	128,340

- If line 8a is zero or less, stop here and attach this form to your return.
- If you answered "Yes" on line 2, go to Part III or Part IV, whichever applies. Otherwise go to line 8b.

b If you haven't replaced your home, do you plan to do so within the replacement period (see Instructions)? (If "Yes," stop here, attach this form to your return, and see Instructions under **Additional Filing Requirements** ☐ Yes ☐ No
- If "No," go to Part III or Part IV, whichever applies.

Part III One-Time Exclusion of Gain for People Age 55 or Older *(If you are not taking the exclusion, go to Part IV now.)*

9a	Were you 55 or older on date of sale?	☑ Yes ☐ No
b	Was your spouse 55 or older on date of sale?	☑ Yes ☐ No
	If you did not answer "Yes" on either line 9a or 9b, go to Part IV now.	
c	Did the person who answered "Yes" on line 9a or 9b own and use the property as his or her main home for a total of at least 3 years (except for short absences) of the 5-year period before the sale? (If "No," go to Part IV now.)	☑ Yes ☐ No
d	**If you answered "Yes" on line 9c, do you elect to take the one-time exclusion?** (If "No," go to Part IV now.)	☑ Yes ☐ No
e	At time of sale, who owned the home?	☐ You ☐ Your spouse ☑ Both of you
f	Social security number of spouse at time of sale if you had a different spouse from the one above at time of sale. (Enter "None" if you were not married at time of sale.) ▶	
g	**Exclusion.** Enter the **smaller** of line 8a or $125,000 ($62,500, if married filing separate return)	9g: 125,000

Part IV Adjusted Sales Price, Taxable Gain, and Adjusted Basis of New Home

10	Subtract the amount from line 9g, if any, from the amount on line 8a	10	3,340
	• If line 10 is zero, stop here and attach this form to your return.		
	• If you answered "Yes" on line 2, go to line 11 now.		
	• If you are reporting the sale on the installment method, stop here and see line 1b Instructions.		
	• All others, stop here and enter this amount on Schedule D, line 3 or line 10, whichever applies.		
11	Fixing-up expenses. (See Instructions for time limits.)	11	1,000
12	**Adjusted sales price.** Subtract line 11 from line 6	12	152,340
13a	Date you moved into new home (month, day, year) ▶ 5 / 1 / 90	b Cost of new home 13b	91,300
14a	Add the amount on line 9g, if any, and the amount on line 13b and enter the total	14a	216,300
b	Subtract line 14a from line 12. If zero or less, enter -0-	14b	0
c	**Taxable gain.** Enter the **smaller** of line 10 or line 14b	14c	0
	• If line 14c is zero, go to line 15 and attach this form to your return.		
	• If you are reporting the sale on the installment method, see line 1b Instructions and go to line 15.		
	• All others, enter this amount on Schedule D, line 3 or line 10 whichever applies, and go to line 15.		
15	Postponed gain. Subtract line 14c from line 10	15	3,340
16	**Adjusted basis of new home.** Subtract line 15 from line 13b	16	87,960

Sign Here Only If You Are Filing This Form by Itself and Not With Your Tax Return

Under penalties of perjury, I declare that I have examined this form, including attachments, and to the best of my knowledge and belief, it is true, correct, and complete.

Your signature ▶ _____ Date _____ Spouse's signature ▶ _____ Date _____

(If a joint return, both must sign.)

For Paperwork Reduction Act Notice, see separate Instructions. Form 2119 (1990)

Filled-in Form 3903 **If you need more information, turn to the page shown in the circle.**

Form **3903** — Department of the Treasury, Internal Revenue Service

(133) Moving Expenses

► Attach to Form 1040.
► See separate instructions.

OMB No 1545-0062
1990
Attachment Sequence No **62**

Name(s) shown on Form 1040: Frank R. and Evelyn D. Jones
Your social security number: 516 00 1492

1 Enter the number of miles from your **old** home to your **new** workplace	1	96
2 Enter the number of miles from your **old** home to your **old** workplace	2	5
3 Subtract line 2 from line 1. Enter the result (but not less than zero) ►	3	91

If line 3 is 35 or more miles, complete the rest of this form. If line 3 is less than 35 miles, you may not deduct your moving expenses. This rule does not apply to members of the armed forces.

Part I Moving Expenses

Section A.—Transportation of Household Goods

4 Transportation and storage for household goods and personal effects	4	530

Section B.—Expenses of Moving From Old To New Home

5 Travel and lodging **not** including meals			5	70
6 Total meals	6	50		
7 Multiply line 6 by 80% (.80)			7	40
8 Add lines 5 and 7			8	110

Section C.—Pre-move Househunting Expenses and Temporary Quarters (for any 30 days in a row after getting your job)

9 Pre-move travel and lodging **not** including meals			9	500
10 Temporary quarters expenses **not** including meals			10	
11 Total meal expenses for both pre-move househunting and temporary quarters	11	200		
12 Multiply line 11 by 80% (.80)			12	160
13 Add lines 9, 10, and 12			13	660

Section D.—Qualified Real Estate Expenses

14 Expenses of (check one): a ☑ selling or exchanging your old home; or b ☐ if renting, settling an unexpired lease			14	9,000
15 Expenses of (check one): a ☑ buying your new home; or b ☐ if renting, getting a new lease			15	1,300

Part II Dollar Limits

16 Enter the amount from line 13	16	660		
17 Enter the **smaller** of line 16 or $1,500 ($750 if married filing a separate return, and at the end of 1990 you lived with your spouse who also started work during 1990)			17	660
18 Add lines 14, 15, and 17			18	10,960
19 Enter the **smaller** of line 18 or $3,000 ($1,500 if married filing a separate return, and at the end of 1990 you lived with your spouse who also started work during 1990)			19	3,000
20 Add lines 4, 8, and 19. This is your moving expense deduction. **Enter here and on Schedule A (Form 1040), line 19. (Note:** *Any payments your employer made for any part of your move (including the value of any services furnished in kind) should be included on Form W-2. Report that amount on* **Form 1040, line 7.** *See* ***Reimbursements*** *in the Instructions.)* ►	20	3,640		

For Paperwork Reduction Act Notice, see separate instructions. Form **3903** (1990)

The Examination and Appeals Process

We examine returns for correctness of income, exemptions, credits, and deductions.

Fairness if Your Return is Examined

Most taxpayers' returns are accepted as filed. But if your return is selected for examination, it does not suggest that you are dishonest. The examination may or may not result in more tax. Your case may be closed without change. Or, you may receive a refund.

Courtesy and consideration. You are entitled to courteous and considerate treatment from IRS employees at all times. If you ever feel that you are not being treated with fairness, courtesy, and consideration by an IRS employee, you should tell the employee's supervisor. Publication 1, *Your Rights as a Taxpayer,* explains the many rights you have as a taxpayer. You can get free publications by calling our toll-free number.

Pay only the required tax. You have the right to plan your business and personal finances in such a way that you will pay the least tax that is due under the law. You are liable only for the correct amount of tax. Our purpose is to apply the law consistently and fairly to all taxpayers.

Privacy and confidentiality. You have the right to have your tax case kept confidential. Under the law, the IRS must protect the privacy of your tax information. However, if a lien or a lawsuit is filed, certain aspects of your tax case will become public record. People who prepare your return or represent you must also keep your information confidential.

You also have the right to know why we are asking you for the information, exactly how we will use it, and what might happen if you do not give it.

Examination of Returns

An examination usually begins when we notify you that your return has been selected. We will tell you which records you will need.

How returns are selected. We select returns for examination by several methods. A computer program called the Discriminant Function System (DIF) is used to select most returns. In this method, the computer uses historical data to give parts of the return a score. IRS personnel then screen the return.

Some returns are selected at random. We also select returns by examining claims for credit or refund and by matching information documents, such as Forms W–2 and 1099, with returns.

Arranging the examination. Many examinations are handled by mail. For information get the free Publication 1383, *The Correspondence Process (Income Tax Accounts).* If we notify you that your examination is to be conducted through a personal interview, or if you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If the time or place we suggest is not convenient, the examiner will try to work out something more suitable. However, we will make the final determination on how, when, and where an examination takes place.

Transfers to another district. Generally, your return is examined in the IRS district where you live. But if it can be examined more quickly and conveniently in another district, such as where your books and records are located, you may ask to have the case transferred to that district.

Representation. Throughout the examination, you may represent yourself, have someone else accompany you, or, with proper written authorization, have someone represent you in your absence. If you want to consult an attorney, an enrolled agent, or any other person permitted to represent a taxpayer during an examination, we will stop and reschedule the interview. We cannot suspend the interview if you are there because of an administrative summons.

Recordings. You can generally make an audio recording of an interview with an IRS Examination officer. Your request to record the interview should be made in writing. You must notify us 10 days before the meeting and bring your own recording equipment. We also can record an interview. If we initiate the recording, we will notify you 10 days before the meeting, and you can get a copy of the recording at your expense.

Repeat examinations. We try to avoid repeat examinations of the same items, but sometimes this happens. If we examined your tax return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so that we can see if we should discontinue the examination.

Explanation of changes. If we propose any changes to your return, we will explain the reasons for the changes. It is important that you understand the reasons for any proposed change. You should not hesitate to ask about anything that is unclear to you.

Agreement with changes. If you agree with the proposed changes, you may sign an agreement form and pay any additional tax you may owe. You must pay interest on any additional tax. If you pay when you sign the agreement, the interest is generally figured from the due date of your return to the date you paid.

If you do not pay the additional tax when you sign the agreement, you will receive a bill. The interest on the additional tax is generally figured from the due date of your return to the billing date. However, you will not be billed for more than 30 days additional interest, even if the bill is delayed.

If you are due a refund, we can refund your money more quickly if you sign the agreement form. You will be paid interest on the refund.

Appealing the Examination Findings

If you do not agree with the examiner's report, you may meet with the examiner's supervisor to discuss your case further. If you still don't agree with the examiner's findings, you have the right to appeal them. The examiner will explain your appeal rights and give you a copy of Publication 5, *Appeal Rights and Preparation of Protests for Unagreed Cases.* This free publication explains your appeal rights in detail and tells you exactly what to do if you want to appeal.

Appeals Office. You can appeal the findings of an examination within the IRS through our Appeals Office. The Appeals Office is independent of your examiner and IRS District Director or Service Center Director. Most differences can be settled through this appeals system without expensive and time-consuming court trials. If the matter cannot be settled to your satisfaction in Appeals, you can take your case to court.

Appeals to the courts. Depending on whether you first pay the disputed tax, you can take your case to the U.S. Tax Court, the U.S. Claims Court, or your U.S. District Court. These courts are entirely independent of the IRS. However, a U.S. Tax Court case is generally reviewed by our Appeals Office before it is heard by the Tax Court. As always, you can represent yourself or have someone admitted to practice before the court represent you.

If you did not yet pay the additional tax and you disagree about whether you owe it, you generally have the right to take your case to the Tax Court. Ordinarily you have 90 days from the time we mail you a formal notice (called a "notice of deficiency") telling you that you owe additional tax to file a petition with the Tax Court.

If you have already paid the disputed tax in full and filed a claim for refund (discussed later) for it that we disallowed (or on which we did not take action within 6 months), then you may take your case to the U.S. District Court or U.S. Claims Court.

Court decisions. We follow Supreme Court decisions. However, we can lose cases in other courts involving taxpayers with the same issue and still apply our interpretation of the law to your situation. You have the right to appeal our decision to do so.

Recovering litigation expenses. If the court agrees with you on most of the issues in your case, and finds the IRS's position to be largely unjustified, you may be able to recover some of your litigation expenses from us. But to do this, you must have used up all the administrative remedies available to you within the IRS, including going through our Appeals system. You may also be able to recover administrative expenses from the IRS. Free Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund,* explains your appeal rights.

Other remedies. If you believe that tax, penalty, or interest was unjustly charged, you have rights which can remedy the situation.

Claims for refund. Once you have paid your tax, you have the right to file a claim for a credit or refund if you believe the tax is too much. The procedure for filing a claim is explained in Chapter 1.

Cancellation of penalties. You have the right to ask that certain penalties (but not interest, as discussed later) be canceled (abated) if you can show reasonable cause for the failure that led to the penalty (or can show that you exercised due diligence, if that is the applicable standard for the penalty).

If you relied on wrong advice given to you by IRS employees on the toll-free telephone system, we will cancel certain penalties that may result. But you have to show that your reliance on the advice was reasonable.

Reduction of interest. If our error caused a delay in your case, and this is grossly unfair, you may be entitled to a reduction of the interest which would otherwise be due. Only delays caused by procedural or mechanical acts that do not involve exercising judgment or discretion qualify. If you think we caused such a delay, please discuss it with the examiner and file a claim.

1990 Tax Table

Use if your taxable income is less than $50,000. If $50,000 or more, use the Tax Rate Schedules.

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
$0	$5	$0	$0	$0	$0
5	15	2	2	2	2
15	25	3	3	3	3
25	50	6	6	6	6
50	75	9	9	9	9
75	100	13	13	13	13
100	125	17	17	17	17
125	150	21	21	21	21
150	175	24	24	24	24
175	200	28	28	28	28
200	225	32	32	32	32
225	250	36	36	36	36
250	275	39	39	39	39
275	300	43	43	43	43
300	325	47	47	47	47
325	350	51	51	51	51
350	375	54	54	54	54
375	400	58	58	58	58
400	425	62	62	62	62
425	450	66	66	66	66
450	475	69	69	69	69
475	500	73	73	73	73
500	525	77	77	77	77
525	550	81	81	81	81
550	575	84	84	84	84
575	600	88	88	88	88
600	625	92	92	92	92
625	650	96	96	96	96
650	675	99	99	99	99
675	700	103	103	103	103
700	725	107	107	107	107
725	750	111	111	111	111
750	775	114	114	114	114
775	800	118	118	118	118
800	825	122	122	122	122
825	850	126	126	126	126
850	875	129	129	129	129
875	900	133	133	133	133
900	925	137	137	137	137
925	950	141	141	141	141
950	975	144	144	144	144
975	1,000	148	148	148	148
1,000					
1,000	1,025	152	152	152	152
1,025	1,050	156	156	156	156
1,050	1,075	159	159	159	159
1,075	1,100	163	163	163	163
1,100	1,125	167	167	167	167
1,125	1,150	171	171	171	171
1,150	1,175	174	174	174	174
1,175	1,200	178	178	178	178
1,200	1,225	182	182	182	182
1,225	1,250	186	186	186	186
1,250	1,275	189	189	189	189
1,275	1,300	193	193	193	193
1,300	1,325	197	197	197	197
1,325	1,350	201	201	201	201
1,350	1,375	204	204	204	204
1,375	1,400	208	208	208	208
1,400	1,425	212	212	212	212
1,425	1,450	216	216	216	216
1,450	1,475	219	219	219	219
1,475	1,500	223	223	223	223
1,500	1,525	227	227	227	227
1,525	1,550	231	231	231	231
1,550	1,575	234	234	234	234
1,575	1,600	238	238	238	238
1,600	1,625	242	242	242	242
1,625	1,650	246	246	246	246
1,650	1,675	249	249	249	249
1,675	1,700	253	253	253	253
1,700	1,725	257	257	257	257
1,725	1,750	261	261	261	261
1,750	1,775	264	264	264	264
1,775	1,800	268	268	268	268
1,800	1,825	272	272	272	272
1,825	1,850	276	276	276	276
1,850	1,875	279	279	279	279
1,875	1,900	283	283	283	283
1,900	1,925	287	287	287	287
1,925	1,950	291	291	291	291
1,950	1,975	294	294	294	294
1,975	2,000	298	298	298	298
2,000					
2,000	2,025	302	302	302	302
2,025	2,050	306	306	306	306
2,050	2,075	309	309	309	309
2,075	2,100	313	313	313	313
2,100	2,125	317	317	317	317
2,125	2,150	321	321	321	321
2,150	2,175	324	324	324	324
2,175	2,200	328	328	328	328
2,200	2,225	332	332	332	332
2,225	2,250	336	336	336	336
2,250	2,275	339	339	339	339
2,275	2,300	343	343	343	343
2,300	2,325	347	347	347	347
2,325	2,350	351	351	351	351
2,350	2,375	354	354	354	354
2,375	2,400	358	358	358	358
2,400	2,425	362	362	362	362
2,425	2,450	366	366	366	366
2,450	2,475	369	369	369	369
2,475	2,500	373	373	373	373
2,500	2,525	377	377	377	377
2,525	2,550	381	381	381	381
2,550	2,575	384	384	384	384
2,575	2,600	388	388	388	388
2,600	2,625	392	392	392	392
2,625	2,650	396	396	396	396
2,650	2,675	399	399	399	399
2,675	2,700	403	403	403	403
2,700	2,725	407	407	407	407
2,725	2,750	411	411	411	411
2,750	2,775	414	414	414	414
2,775	2,800	418	418	418	418
2,800	2,825	422	422	422	422
2,825	2,850	426	426	426	426
2,850	2,875	429	429	429	429
2,875	2,900	433	433	433	433
2,900	2,925	437	437	437	437
2,925	2,950	441	441	441	441
2,950	2,975	444	444	444	444
2,975	3,000	448	448	448	448
3,000					
3,000	3,050	454	454	454	454
3,050	3,100	461	461	461	461
3,100	3,150	469	469	469	469
3,150	3,200	476	476	476	476
3,200	3,250	484	484	484	484
3,250	3,300	491	491	491	491
3,300	3,350	499	499	499	499
3,350	3,400	506	506	506	506
3,400	3,450	514	514	514	514
3,450	3,500	521	521	521	521
3,500	3,550	529	529	529	529
3,550	3,600	536	536	536	536
3,600	3,650	544	544	544	544
3,650	3,700	551	551	551	551
3,700	3,750	559	559	559	559
3,750	3,800	566	566	566	566
3,800	3,850	574	574	574	574
3,850	3,900	581	581	581	581
3,900	3,950	589	589	589	589
3,950	4,000	596	596	596	596
4,000					
4,000	4,050	604	604	604	604
4,050	4,100	611	611	611	611
4,100	4,150	619	619	619	619
4,150	4,200	626	626	626	626
4,200	4,250	634	634	634	634
4,250	4,300	641	641	641	641
4,300	4,350	649	649	649	649
4,350	4,400	656	656	656	656
4,400	4,450	664	664	664	664
4,450	4,500	671	671	671	671
4,500	4,550	679	679	679	679
4,550	4,600	686	686	686	686
4,600	4,650	694	694	694	694
4,650	4,700	701	701	701	701
4,700	4,750	709	709	709	709
4,750	4,800	716	716	716	716
4,800	4,850	724	724	724	724
4,850	4,900	731	731	731	731
4,900	4,950	739	739	739	739
4,950	5,000	746	746	746	746

* This column must also be used by a qualifying widow(er).

Continued on next page

1990 Tax Table —*Continued*

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—				If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—				If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
5,000						**8,000**						**11,000**					
5,000	5,050	754	754	754	754	8,000	8,050	1,204	1,204	1,204	1,204	11,000	11,050	1,654	1,654	1,654	1,654
5,050	5,100	761	761	761	761	8,050	8,100	1,211	1,211	1,211	1,211	11,050	11,100	1,661	1,661	1,661	1,661
5,100	5,150	769	769	769	769	8,100	8,150	1,219	1,219	1,219	1,219	11,100	11,150	1,669	1,669	1,669	1,669
5,150	5,200	776	776	776	776	8,150	8,200	1,226	1,226	1,226	1,226	11,150	11,200	1,676	1,676	1,676	1,676
5,200	5,250	784	784	784	784	8,200	8,250	1,234	1,234	1,234	1,234	11,200	11,250	1,684	1,684	1,684	1,684
5,250	5,300	791	791	791	791	8,250	8,300	1,241	1,241	1,241	1,241	11,250	11,300	1,691	1,691	1,691	1,691
5,300	5,350	799	799	799	799	8,300	8,350	1,249	1,249	1,249	1,249	11,300	11,350	1,699	1,699	1,699	1,699
5,350	5,400	806	806	806	806	8,350	8,400	1,256	1,256	1,256	1,256	11,350	11,400	1,706	1,706	1,706	1,706
5,400	5,450	814	814	814	814	8,400	8,450	1,264	1,264	1,264	1,264	11,400	11,450	1,714	1,714	1,714	1,714
5,450	5,500	821	821	821	821	8,450	8,500	1,271	1,271	1,271	1,271	11,450	11,500	1,721	1,721	1,721	1,721
5,500	5,550	829	829	829	829	8,500	8,550	1,279	1,279	1,279	1,279	11,500	11,550	1,729	1,729	1,729	1,729
5,550	5,600	836	836	836	836	8,550	8,600	1,286	1,286	1,286	1,286	11,550	11,600	1,736	1,736	1,736	1,736
5,600	5,650	844	844	844	844	8,600	8,650	1,294	1,294	1,294	1,294	11,600	11,650	1,744	1,744	1,744	1,744
5,650	5,700	851	851	851	851	8,650	8,700	1,301	1,301	1,301	1,301	11,650	11,700	1,751	1,751	1,751	1,751
5,700	5,750	859	859	859	859	8,700	8,750	1,309	1,309	1,309	1,309	11,700	11,750	1,759	1,759	1,759	1,759
5,750	5,800	866	866	866	866	8,750	8,800	1,316	1,316	1,316	1,316	11,750	11,800	1,766	1,766	1,766	1,766
5,800	5,850	874	874	874	874	8,800	8,850	1,324	1,324	1,324	1,324	11,800	11,850	1,774	1,774	1,774	1,774
5,850	5,900	881	881	881	881	8,850	8,900	1,331	1,331	1,331	1,331	11,850	11,900	1,781	1,781	1,781	1,781
5,900	5,950	889	889	889	889	8,900	8,950	1,339	1,339	1,339	1,339	11,900	11,950	1,789	1,789	1,789	1,789
5,950	6,000	896	896	896	896	8,950	9,000	1,346	1,346	1,346	1,346	11,950	12,000	1,796	1,796	1,796	1,796
6,000						**9,000**						**12,000**					
6,000	6,050	904	904	904	904	9,000	9,050	1,354	1,354	1,354	1,354	12,000	12,050	1,804	1,804	1,804	1,804
6,050	6,100	911	911	911	911	9,050	9,100	1,361	1,361	1,361	1,361	12,050	12,100	1,811	1,811	1,811	1,811
6,100	6,150	919	919	919	919	9,100	9,150	1,369	1,369	1,369	1,369	12,100	12,150	1,819	1,819	1,819	1,819
6,150	6,200	926	926	926	926	9,150	9,200	1,376	1,376	1,376	1,376	12,150	12,200	1,826	1,826	1,826	1,826
6,200	6,250	934	934	934	934	9,200	9,250	1,384	1,384	1,384	1,384	12,200	12,250	1,834	1,834	1,834	1,834
6,250	6,300	941	941	941	941	9,250	9,300	1,391	1,391	1,391	1,391	12,250	12,300	1,841	1,841	1,841	1,841
6,300	6,350	949	949	949	949	9,300	9,350	1,399	1,399	1,399	1,399	12,300	12,350	1,849	1,849	1,849	1,849
6,350	6,400	956	956	956	956	9,350	9,400	1,406	1,406	1,406	1,406	12,350	12,400	1,856	1,856	1,856	1,856
6,400	6,450	964	964	964	964	9,400	9,450	1,414	1,414	1,414	1,414	12,400	12,450	1,864	1,864	1,864	1,864
6,450	6,500	971	971	971	971	9,450	9,500	1,421	1,421	1,421	1,421	12,450	12,500	1,871	1,871	1,871	1,871
6,500	6,550	979	979	979	979	9,500	9,550	1,429	1,429	1,429	1,429	12,500	12,550	1,879	1,879	1,879	1,879
6,550	6,600	986	986	986	986	9,550	9,600	1,436	1,436	1,436	1,436	12,550	12,600	1,886	1,886	1,886	1,886
6,600	6,650	994	994	994	994	9,600	9,650	1,444	1,444	1,444	1,444	12,600	12,650	1,894	1,894	1,894	1,894
6,650	6,700	1,001	1,001	1,001	1,001	9,650	9,700	1,451	1,451	1,451	1,451	12,650	12,700	1,901	1,901	1,901	1,901
6,700	6,750	1,009	1,009	1,009	1,009	9,700	9,750	1,459	1,459	1,459	1,459	12,700	12,750	1,909	1,909	1,909	1,909
6,750	6,800	1,016	1,016	1,016	1,016	9,750	9,800	1,466	1,466	1,466	1,466	12,750	12,800	1,916	1,916	1,916	1,916
6,800	6,850	1,024	1,024	1,024	1,024	9,800	9,850	1,474	1,474	1,474	1,474	12,800	12,850	1,924	1,924	1,924	1,924
6,850	6,900	1,031	1,031	1,031	1,031	9,850	9,900	1,481	1,481	1,481	1,481	12,850	12,900	1,931	1,931	1,931	1,931
6,900	6,950	1,039	1,039	1,039	1,039	9,900	9,950	1,489	1,489	1,489	1,489	12,900	12,950	1,939	1,939	1,939	1,939
6,950	7,000	1,046	1,046	1,046	1,046	9,950	10,000	1,496	1,496	1,496	1,496	12,950	13,000	1,946	1,946	1,946	1,946
7,000						**10,000**						**13,000**					
7,000	7,050	1,054	1,054	1,054	1,054	10,000	10,050	1,504	1,504	1,504	1,504	13,000	13,050	1,954	1,954	1,954	1,954
7,050	7,100	1,061	1,061	1,061	1,061	10,050	10,100	1,511	1,511	1,511	1,511	13,050	13,100	1,961	1,961	1,961	1,961
7,100	7,150	1,069	1,069	1,069	1,069	10,100	10,150	1,519	1,519	1,519	1,519	13,100	13,150	1,969	1,969	1,969	1,969
7,150	7,200	1,076	1,076	1,076	1,076	10,150	10,200	1,526	1,526	1,526	1,526	13,150	13,200	1,976	1,976	1,976	1,976
7,200	7,250	1,084	1,084	1,084	1,084	10,200	10,250	1,534	1,534	1,534	1,534	13,200	13,250	1,984	1,984	1,984	1,984
7,250	7,300	1,091	1,091	1,091	1,091	10,250	10,300	1,541	1,541	1,541	1,541	13,250	13,300	1,991	1,991	1,991	1,991
7,300	7,350	1,099	1,099	1,099	1,099	10,300	10,350	1,549	1,549	1,549	1,549	13,300	13,350	1,999	1,999	1,999	1,999
7,350	7,400	1,106	1,106	1,106	1,106	10,350	10,400	1,556	1,556	1,556	1,556	13,350	13,400	2,006	2,006	2,006	2,006
7,400	7,450	1,114	1,114	1,114	1,114	10,400	10,450	1,564	1,564	1,564	1,564	13,400	13,450	2,014	2,014	2,014	2,014
7,450	7,500	1,121	1,121	1,121	1,121	10,450	10,500	1,571	1,571	1,571	1,571	13,450	13,500	2,021	2,021	2,021	2,021
7,500	7,550	1,129	1,129	1,129	1,129	10,500	10,550	1,579	1,579	1,579	1,579	13,500	13,550	2,029	2,029	2,029	2,029
7,550	7,600	1,136	1,136	1,136	1,136	10,550	10,600	1,586	1,586	1,586	1,586	13,550	13,600	2,036	2,036	2,036	2,036
7,600	7,650	1,144	1,144	1,144	1,144	10,600	10,650	1,594	1,594	1,594	1,594	13,600	13,650	2,044	2,044	2,044	2,044
7,650	7,700	1,151	1,151	1,151	1,151	10,650	10,700	1,601	1,601	1,601	1,601	13,650	13,700	2,051	2,051	2,051	2,051
7,700	7,750	1,159	1,159	1,159	1,159	10,700	10,750	1,609	1,609	1,609	1,609	13,700	13,750	2,059	2,059	2,059	2,059
7,750	7,800	1,166	1,166	1,166	1,166	10,750	10,800	1,616	1,616	1,616	1,616	13,750	13,800	2,066	2,066	2,066	2,066
7,800	7,850	1,174	1,174	1,174	1,174	10,800	10,850	1,624	1,624	1,624	1,624	13,800	13,850	2,074	2,074	2,074	2,074
7,850	7,900	1,181	1,181	1,181	1,181	10,850	10,900	1,631	1,631	1,631	1,631	13,850	13,900	2,081	2,081	2,081	2,081
7,900	7,950	1,189	1,189	1,189	1,189	10,900	10,950	1,639	1,639	1,639	1,639	13,900	13,950	2,089	2,089	2,089	2,089
7,950	8,000	1,196	1,196	1,196	1,196	10,950	11,000	1,646	1,646	1,646	1,646	13,950	14,000	2,096	2,096	2,096	2,096

* This column must also be used by a qualifying widow(er).

Continued on next page

1990 Tax Table—*Continued*

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
14,000					
14,000	14,050	2,104	2,104	2,104	2,104
14,050	14,100	2,111	2,111	2,111	2,111
14,100	14,150	2,119	2,119	2,119	2,119
14,150	14,200	2,126	2,126	2,126	2,126
14,200	14,250	2,134	2,134	2,134	2,134
14,250	14,300	2,141	2,141	2,141	2,141
14,300	14,350	2,149	2,149	2,149	2,149
14,350	14,400	2,156	2,156	2,156	2,156
14,400	14,450	2,164	2,164	2,164	2,164
14,450	14,500	2,171	2,171	2,171	2,171
14,500	14,550	2,179	2,179	2,179	2,179
14,550	14,600	2,186	2,186	2,186	2,186
14,600	14,650	2,194	2,194	2,194	2,194
14,650	14,700	2,201	2,201	2,201	2,201
14,700	14,750	2,209	2,209	2,209	2,209
14,750	14,800	2,216	2,216	2,216	2,216
14,800	14,850	2,224	2,224	2,224	2,224
14,850	14,900	2,231	2,231	2,231	2,231
14,900	14,950	2,239	2,239	2,239	2,239
14,950	15,000	2,246	2,246	2,246	2,246
15,000					
15,000	15,050	2,254	2,254	2,254	2,254
15,050	15,100	2,261	2,261	2,261	2,261
15,100	15,150	2,269	2,269	2,269	2,269
15,150	15,200	2,276	2,276	2,276	2,276
15,200	15,250	2,284	2,284	2,284	2,284
15,250	15,300	2,291	2,291	2,291	2,291
15,300	15,350	2,299	2,299	2,299	2,299
15,350	15,400	2,306	2,306	2,306	2,306
15,400	15,450	2,314	2,314	2,314	2,314
15,450	15,500	2,321	2,321	2,321	2,321
15,500	15,550	2,329	2,329	2,329	2,329
15,550	15,600	2,336	2,336	2,336	2,336
15,600	15,650	2,344	2,344	2,344	2,344
15,650	15,700	2,351	2,351	2,351	2,351
15,700	15,750	2,359	2,359	2,359	2,359
15,750	15,800	2,366	2,366	2,366	2,366
15,800	15,850	2,374	2,374	2,374	2,374
15,850	15,900	2,381	2,381	2,381	2,381
15,900	15,950	2,389	2,389	2,389	2,389
15,950	16,000	2,396	2,396	2,396	2,396
16,000					
16,000	16,050	2,404	2,404	2,404	2,404
16,050	16,100	2,411	2,411	2,411	2,411
16,100	16,150	2,419	2,419	2,419	2,419
16,150	16,200	2,426	2,426	2,426	2,426
16,200	16,250	2,434	2,434	2,434	2,434
16,250	16,300	2,441	2,441	2,448	2,441
16,300	16,350	2,449	2,449	2,462	2,449
16,350	16,400	2,456	2,456	2,476	2,456
16,400	16,450	2,464	2,464	2,490	2,464
16,450	16,500	2,471	2,471	2,504	2,471
16,500	16,550	2,479	2,479	2,518	2,479
16,550	16,600	2,486	2,486	2,532	2,486
16,600	16,650	2,494	2,494	2,546	2,494
16,650	16,700	2,501	2,501	2,560	2,501
16,700	16,750	2,509	2,509	2,574	2,509
16,750	16,800	2,516	2,516	2,588	2,516
16,800	16,850	2,524	2,524	2,602	2,524
16,850	16,900	2,531	2,531	2,616	2,531
16,900	16,950	2,539	2,539	2,630	2,539
16,950	17,000	2,546	2,546	2,644	2,546
17,000					
17,000	17,050	2,554	2,554	2,658	2,554
17,050	17,100	2,561	2,561	2,672	2,561
17,100	17,150	2,569	2,569	2,686	2,569
17,150	17,200	2,576	2,576	2,700	2,576
17,200	17,250	2,584	2,584	2,714	2,584
17,250	17,300	2,591	2,591	2,728	2,591
17,300	17,350	2,599	2,599	2,742	2,599
17,350	17,400	2,606	2,606	2,756	2,606
17,400	17,450	2,614	2,614	2,770	2,614
17,450	17,500	2,621	2,621	2,784	2,621
17,500	17,550	2,629	2,629	2,798	2,629
17,550	17,600	2,636	2,636	2,812	2,636
17,600	17,650	2,644	2,644	2,826	2,644
17,650	17,700	2,651	2,651	2,840	2,651
17,700	17,750	2,659	2,659	2,854	2,659
17,750	17,800	2,666	2,666	2,868	2,666
17,800	17,850	2,674	2,674	2,882	2,674
17,850	17,900	2,681	2,681	2,896	2,681
17,900	17,950	2,689	2,689	2,910	2,689
17,950	18,000	2,696	2,696	2,924	2,696
18,000					
18,000	18,050	2,704	2,704	2,938	2,704
18,050	18,100	2,711	2,711	2,952	2,711
18,100	18,150	2,719	2,719	2,966	2,719
18,150	18,200	2,726	2,726	2,980	2,726
18,200	18,250	2,734	2,734	2,994	2,734
18,250	18,300	2,741	2,741	3,008	2,741
18,300	18,350	2,749	2,749	3,022	2,749
18,350	18,400	2,756	2,756	3,036	2,756
18,400	18,450	2,764	2,764	3,050	2,764
18,450	18,500	2,771	2,771	3,064	2,771
18,500	18,550	2,779	2,779	3,078	2,779
18,550	18,600	2,786	2,786	3,092	2,786
18,600	18,650	2,794	2,794	3,106	2,794
18,650	18,700	2,801	2,801	3,120	2,801
18,700	18,750	2,809	2,809	3,134	2,809
18,750	18,800	2,816	2,816	3,148	2,816
18,800	18,850	2,824	2,824	3,162	2,824
18,850	18,900	2,831	2,831	3,176	2,831
18,900	18,950	2,839	2,839	3,190	2,839
18,950	19,000	2,846	2,846	3,204	2,846
19,000					
19,000	19,050	2,854	2,854	3,218	2,854
19,050	19,100	2,861	2,861	3,232	2,861
19,100	19,150	2,869	2,869	3,246	2,869
19,150	19,200	2,876	2,876	3,260	2,876
19,200	19,250	2,884	2,884	3,274	2,884
19,250	19,300	2,891	2,891	3,288	2,891
19,300	19,350	2,899	2,899	3,302	2,899
19,350	19,400	2,906	2,906	3,316	2,906
19,400	19,450	2,914	2,914	3,330	2,914
19,450	19,500	2,925	2,921	3,344	2,921
19,500	19,550	2,939	2,929	3,358	2,929
19,550	19,600	2,953	2,936	3,372	2,936
19,600	19,650	2,967	2,944	3,386	2,944
19,650	19,700	2,981	2,951	3,400	2,951
19,700	19,750	2,995	2,959	3,414	2,959
19,750	19,800	3,009	2,966	3,428	2,966
19,800	19,850	3,023	2,974	3,442	2,974
19,850	19,900	3,037	2,981	3,456	2,981
19,900	19,950	3,051	2,989	3,470	2,989
19,950	20,000	3,065	2,996	3,484	2,996
20,000					
20,000	20,050	3,079	3,004	3,498	3,004
20,050	20,100	3,093	3,011	3,512	3,011
20,100	20,150	3,107	3,019	3,526	3,019
20,150	20,200	3,121	3,026	3,540	3,026
20,200	20,250	3,135	3,034	3,554	3,034
20,250	20,300	3,149	3,041	3,568	3,041
20,300	20,350	3,163	3,049	3,582	3,049
20,350	20,400	3,177	3,056	3,596	3,056
20,400	20,450	3,191	3,064	3,610	3,064
20,450	20,500	3,205	3,071	3,624	3,071
20,500	20,550	3,219	3,079	3,638	3,079
20,550	20,600	3,233	3,086	3,652	3,086
20,600	20,650	3,247	3,094	3,666	3,094
20,650	20,700	3,261	3,101	3,680	3,101
20,700	20,750	3,275	3,109	3,694	3,109
20,750	20,800	3,289	3,116	3,708	3,116
20,800	20,850	3,303	3,124	3,722	3,124
20,850	20,900	3,317	3,131	3,736	3,131
20,900	20,950	3,331	3,139	3,750	3,139
20,950	21,000	3,345	3,146	3,764	3,146
21,000					
21,000	21,050	3,359	3,154	3,778	3,154
21,050	21,100	3,373	3,161	3,792	3,161
21,100	21,150	3,387	3,169	3,806	3,169
21,150	21,200	3,401	3,176	3,820	3,176
21,200	21,250	3,415	3,184	3,834	3,184
21,250	21,300	3,429	3,191	3,848	3,191
21,300	21,350	3,443	3,199	3,862	3,199
21,350	21,400	3,457	3,206	3,876	3,206
21,400	21,450	3,471	3,214	3,890	3,214
21,450	21,500	3,485	3,221	3,904	3,221
21,500	21,550	3,499	3,229	3,918	3,229
21,550	21,600	3,513	3,236	3,932	3,236
21,600	21,650	3,527	3,244	3,946	3,244
21,650	21,700	3,541	3,251	3,960	3,251
21,700	21,750	3,555	3,259	3,974	3,259
21,750	21,800	3,569	3,266	3,988	3,266
21,800	21,850	3,583	3,274	4,002	3,274
21,850	21,900	3,597	3,281	4,016	3,281
21,900	21,950	3,611	3,289	4,030	3,289
21,950	22,000	3,625	3,296	4,044	3,296
22,000					
22,000	22,050	3,639	3,304	4,058	3,304
22,050	22,100	3,653	3,311	4,072	3,311
22,100	22,150	3,667	3,319	4,086	3,319
22,150	22,200	3,681	3,326	4,100	3,326
22,200	22,250	3,695	3,334	4,114	3,334
22,250	22,300	3,709	3,341	4,128	3,341
22,300	22,350	3,723	3,349	4,142	3,349
22,350	22,400	3,737	3,356	4,156	3,356
22,400	22,450	3,751	3,364	4,170	3,364
22,450	22,500	3,765	3,371	4,184	3,371
22,500	22,550	3,779	3,379	4,198	3,379
22,550	22,600	3,793	3,386	4,212	3,386
22,600	22,650	3,807	3,394	4,226	3,394
22,650	22,700	3,821	3,401	4,240	3,401
22,700	22,750	3,835	3,409	4,254	3,409
22,750	22,800	3,849	3,416	4,268	3,416
22,800	22,850	3,863	3,424	4,282	3,424
22,850	22,900	3,877	3,431	4,296	3,431
22,900	22,950	3,891	3,439	4,310	3,439
22,950	23,000	3,905	3,446	4,324	3,446

Continued on next page

* This column must also be used by a qualifying widow(er).

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
23,000					
23,000	23,050	3,919	3,454	4,338	3,454
23,050	23,100	3,933	3,461	4,352	3,461
23,100	23,150	3,947	3,469	4,366	3,469
23,150	23,200	3,961	3,476	4,380	3,476
23,200	23,250	3,975	3,484	4,394	3,484
23,250	23,300	3,989	3,491	4,408	3,491
23,300	23,350	4,003	3,499	4,422	3,499
23,350	23,400	4,017	3,506	4,436	3,506
23,400	23,450	4,031	3,514	4,450	3,514
23,450	23,500	4,045	3,521	4,464	3,521
23,500	23,550	4,059	3,529	4,478	3,529
23,550	23,600	4,073	3,536	4,492	3,536
23,600	23,650	4,087	3,544	4,506	3,544
23,650	23,700	4,101	3,551	4,520	3,551
23,700	23,750	4,115	3,559	4,534	3,559
23,750	23,800	4,129	3,566	4,548	3,566
23,800	23,850	4,143	3,574	4,562	3,574
23,850	23,900	4,157	3,581	4,576	3,581
23,900	23,950	4,171	3,589	4,590	3,589
23,950	24,000	4,185	3,596	4,604	3,596
24,000					
24,000	24,050	4,199	3,604	4,618	3,604
24,050	24,100	4,213	3,611	4,632	3,611
24,100	24,150	4,227	3,619	4,646	3,619
24,150	24,200	4,241	3,626	4,660	3,626
24,200	24,250	4,255	3,634	4,674	3,634
24,250	24,300	4,269	3,641	4,688	3,641
24,300	24,350	4,283	3,649	4,702	3,649
24,350	24,400	4,297	3,656	4,716	3,656
24,400	24,450	4,311	3,664	4,730	3,664
24,450	24,500	4,325	3,671	4,744	3,671
24,500	24,550	4,339	3,679	4,758	3,679
24,550	24,600	4,353	3,686	4,772	3,686
24,600	24,650	4,367	3,694	4,786	3,694
24,650	24,700	4,381	3,701	4,800	3,701
24,700	24,750	4,395	3,709	4,814	3,709
24,750	24,800	4,409	3,716	4,828	3,716
24,800	24,850	4,423	3,724	4,842	3,724
24,850	24,900	4,437	3,731	4,856	3,731
24,900	24,950	4,451	3,739	4,870	3,739
24,950	25,000	4,465	3,746	4,884	3,746
25,000					
25,000	25,050	4,479	3,754	4,898	3,754
25,050	25,100	4,493	3,761	4,912	3,761
25,100	25,150	4,507	3,769	4,926	3,769
25,150	25,200	4,521	3,776	4,940	3,776
25,200	25,250	4,535	3,784	4,954	3,784
25,250	25,300	4,549	3,791	4,968	3,791
25,300	25,350	4,563	3,799	4,982	3,799
25,350	25,400	4,577	3,806	4,996	3,806
25,400	25,450	4,591	3,814	5,010	3,814
25,450	25,500	4,605	3,821	5,024	3,821
25,500	25,550	4,619	3,829	5,038	3,829
25,550	25,600	4,633	3,836	5,052	3,836
25,600	25,650	4,647	3,844	5,066	3,844
25,650	25,700	4,661	3,851	5,080	3,851
25,700	25,750	4,675	3,859	5,094	3,859
25,750	25,800	4,689	3,866	5,108	3,866
25,800	25,850	4,703	3,874	5,122	3,874
25,850	25,900	4,717	3,881	5,136	3,881
25,900	25,950	4,731	3,889	5,150	3,889
25,950	26,000	4,745	3,896	5,164	3,896
26,000					
26,000	26,050	4,759	3,904	5,178	3,904
26,050	26,100	4,773	3,911	5,192	3,915
26,100	26,150	4,787	3,919	5,206	3,929
26,150	26,200	4,801	3,926	5,220	3,943
26,200	26,250	4,815	3,934	5,234	3,957
26,250	26,300	4,829	3,941	5,248	3,971
26,300	26,350	4,843	3,949	5,262	3,985
26,350	26,400	4,857	3,956	5,276	3,999
26,400	26,450	4,871	3,964	5,290	4,013
26,450	26,500	4,885	3,971	5,304	4,027
26,500	26,550	4,899	3,979	5,318	4,041
26,550	26,600	4,913	3,986	5,332	4,055
26,600	26,650	4,927	3,994	5,346	4,069
26,650	26,700	4,941	4,001	5,360	4,083
26,700	26,750	4,955	4,009	5,374	4,097
26,750	26,800	4,969	4,016	5,388	4,111
26,800	26,850	4,983	4,024	5,402	4,125
26,850	26,900	4,997	4,031	5,416	4,139
26,900	26,950	5,011	4,039	5,430	4,153
26,950	27,000	5,025	4,046	5,444	4,167
27,000					
27,000	27,050	5,039	4,054	5,458	4,181
27,050	27,100	5,053	4,061	5,472	4,195
27,100	27,150	5,067	4,069	5,486	4,209
27,150	27,200	5,081	4,076	5,500	4,223
27,200	27,250	5,095	4,084	5,514	4,237
27,250	27,300	5,109	4,091	5,528	4,251
27,300	27,350	5,123	4,099	5,542	4,265
27,350	27,400	5,137	4,106	5,556	4,279
27,400	27,450	5,151	4,114	5,570	4,293
27,450	27,500	5,165	4,121	5,584	4,307
27,500	27,550	5,179	4,129	5,598	4,321
27,550	27,600	5,193	4,136	5,612	4,335
27,600	27,650	5,207	4,144	5,626	4,349
27,650	27,700	5,221	4,151	5,640	4,363
27,700	27,750	5,235	4,159	5,654	4,377
27,750	27,800	5,249	4,166	5,668	4,391
27,800	27,850	5,263	4,174	5,682	4,405
27,850	27,900	5,277	4,181	5,696	4,419
27,900	27,950	5,291	4,189	5,710	4,433
27,950	28,000	5,305	4,196	5,724	4,447
28,000					
28,000	28,050	5,319	4,204	5,738	4,461
28,050	28,100	5,333	4,211	5,752	4,475
28,100	28,150	5,347	4,219	5,766	4,489
28,150	28,200	5,361	4,226	5,780	4,503
28,200	28,250	5,375	4,234	5,794	4,517
28,250	28,300	5,389	4,241	5,808	4,531
28,300	28,350	5,403	4,249	5,822	4,545
28,350	28,400	5,417	4,256	5,836	4,559
28,400	28,450	5,431	4,264	5,850	4,573
28,450	28,500	5,445	4,271	5,864	4,587
28,500	28,550	5,459	4,279	5,878	4,601
28,550	28,600	5,473	4,286	5,892	4,615
28,600	28,650	5,487	4,294	5,906	4,629
28,650	28,700	5,501	4,301	5,920	4,643
28,700	28,750	5,515	4,309	5,934	4,657
28,750	28,800	5,529	4,316	5,948	4,671
28,800	28,850	5,543	4,324	5,962	4,685
28,850	28,900	5,557	4,331	5,976	4,699
28,900	28,950	5,571	4,339	5,990	4,713
28,950	29,000	5,585	4,346	6,004	4,727
29,000					
29,000	29,050	5,599	4,354	6,018	4,741
29,050	29,100	5,613	4,361	6,032	4,755
29,100	29,150	5,627	4,369	6,046	4,769
29,150	29,200	5,641	4,376	6,060	4,783
29,200	29,250	5,655	4,384	6,074	4,797
29,250	29,300	5,669	4,391	6,088	4,811
29,300	29,350	5,683	4,399	6,102	4,825
29,350	29,400	5,697	4,406	6,116	4,839
29,400	29,450	5,711	4,414	6,130	4,853
29,450	29,500	5,725	4,421	6,144	4,867
29,500	29,550	5,739	4,429	6,158	4,881
29,550	29,600	5,753	4,436	6,172	4,895
29,600	29,650	5,767	4,444	6,186	4,909
29,650	29,700	5,781	4,451	6,200	4,923
29,700	29,750	5,795	4,459	6,214	4,937
29,750	29,800	5,809	4,466	6,228	4,951
29,800	29,850	5,823	4,474	6,242	4,965
29,850	29,900	5,837	4,481	6,256	4,979
29,900	29,950	5,851	4,489	6,270	4,993
29,950	30,000	5,865	4,496	6,284	5,007
30,000					
30,000	30,050	5,879	4,504	6,298	5,021
30,050	30,100	5,893	4,511	6,312	5,035
30,100	30,150	5,907	4,519	6,326	5,049
30,150	30,200	5,921	4,526	6,340	5,063
30,200	30,250	5,935	4,534	6,354	5,077
30,250	30,300	5,949	4,541	6,368	5,091
30,300	30,350	5,963	4,549	6,382	5,105
30,350	30,400	5,977	4,556	6,396	5,119
30,400	30,450	5,991	4,564	6,410	5,133
30,450	30,500	6,005	4,571	6,424	5,147
30,500	30,550	6,019	4,579	6,438	5,161
30,550	30,600	6,033	4,586	6,452	5,175
30,600	30,650	6,047	4,594	6,466	5,189
30,650	30,700	6,061	4,601	6,480	5,203
30,700	30,750	6,075	4,609	6,494	5,217
30,750	30,800	6,089	4,616	6,508	5,231
30,800	30,850	6,103	4,624	6,522	5,245
30,850	30,900	6,117	4,631	6,536	5,259
30,900	30,950	6,131	4,639	6,550	5,273
30,950	31,000	6,145	4,646	6,564	5,287
31,000					
31,000	31,050	6,159	4,654	6,578	5,301
31,050	31,100	6,173	4,661	6,592	5,315
31,100	31,150	6,187	4,669	6,606	5,329
31,150	31,200	6,201	4,676	6,620	5,343
31,200	31,250	6,215	4,684	6,634	5,357
31,250	31,300	6,229	4,691	6,648	5,371
31,300	31,350	6,243	4,699	6,662	5,385
31,350	31,400	6,257	4,706	6,676	5,399
31,400	31,450	6,271	4,714	6,690	5,413
31,450	31,500	6,285	4,721	6,704	5,427
31,500	31,550	6,299	4,729	6,718	5,441
31,550	31,600	6,313	4,736	6,732	5,455
31,600	31,650	6,327	4,744	6,746	5,469
31,650	31,700	6,341	4,751	6,760	5,483
31,700	31,750	6,355	4,759	6,774	5,497
31,750	31,800	6,369	4,766	6,788	5,511
31,800	31,850	6,383	4,774	6,802	5,525
31,850	31,900	6,397	4,781	6,816	5,539
31,900	31,950	6,411	4,789	6,830	5,553
31,950	32,000	6,425	4,796	6,844	5,567

* This column must also be used by a qualifying widow(er).

Continued on next page

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—				If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—				If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household	At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—						Your tax is—						Your tax is—			
32,000						35,000						38,000					
32,000	32,050	6,439	4,804	6,858	5,581	35,000	35,050	7,279	5,589	7,698	6,421	38,000	38,050	8,119	6,429	8,538	7,261
32,050	32,100	6,453	4,811	6,872	5,595	35,050	35,100	7,293	5,603	7,712	6,435	38,050	38,100	8,133	6,443	8,552	7,275
32,100	32,150	6,467	4,819	6,886	5,609	35,100	35,150	7,307	5,617	7,726	6,449	38,100	38,150	8,147	6,457	8,566	7,289
32,150	32,200	6,481	4,826	6,900	5,623	35,150	35,200	7,321	5,631	7,740	6,463	38,150	38,200	8,161	6,471	8,580	7,303
32,200	32,250	6,495	4,834	6,914	5,637	35,200	35,250	7,335	5,645	7,754	6,477	38,200	38,250	8,175	6,485	8,594	7,317
32,250	32,300	6,509	4,841	6,928	5,651	35,250	35,300	7,349	5,659	7,768	6,491	38,250	38,300	8,189	6,499	8,608	7,331
32,300	32,350	6,523	4,849	6,942	5,665	35,300	35,350	7,363	5,673	7,782	6,505	38,300	38,350	8,203	6,513	8,622	7,345
32,350	32,400	6,537	4,856	6,956	5,679	35,350	35,400	7,377	5,687	7,796	6,519	38,350	38,400	8,217	6,527	8,636	7,359
32,400	32,450	6,551	4,864	6,970	5,693	35,400	35,450	7,391	5,701	7,810	6,533	38,400	38,450	8,231	6,541	8,650	7,373
32,450	32,500	6,565	4,875	6,984	5,707	35,450	35,500	7,405	5,715	7,824	6,547	38,450	38,500	8,245	6,555	8,664	7,387
32,500	32,550	6,579	4,889	6,998	5,721	35,500	35,550	7,419	5,729	7,838	6,561	38,500	38,550	8,259	6,569	8,678	7,401
32,550	32,600	6,593	4,903	7,012	5,735	35,550	35,600	7,433	5,743	7,852	6,575	38,550	38,600	8,273	6,583	8,692	7,415
32,600	32,650	6,607	4,917	7,026	5,749	35,600	35,650	7,447	5,757	7,866	6,589	38,600	38,650	8,287	6,597	8,706	7,429
32,650	32,700	6,621	4,931	7,040	5,763	35,650	35,700	7,461	5,771	7,880	6,603	38,650	38,700	8,301	6,611	8,720	7,443
32,700	32,750	6,635	4,945	7,054	5,777	35,700	35,750	7,475	5,785	7,894	6,617	38,700	38,750	8,315	6,625	8,734	7,457
32,750	32,800	6,649	4,959	7,068	5,791	35,750	35,800	7,489	5,799	7,908	6,631	38,750	38,800	8,329	6,639	8,748	7,471
32,800	32,850	6,663	4,973	7,082	5,805	35,800	35,850	7,503	5,813	7,922	6,645	38,800	38,850	8,343	6,653	8,762	7,485
32,850	32,900	6,677	4,987	7,096	5,819	35,850	35,900	7,517	5,827	7,936	6,659	38,850	38,900	8,357	6,667	8,776	7,499
32,900	32,950	6,691	5,001	7,110	5,833	35,900	35,950	7,531	5,841	7,950	6,673	38,900	38,950	8,371	6,681	8,790	7,513
32,950	33,000	6,705	5,015	7,124	5,847	35,950	36,000	7,545	5,855	7,964	6,687	38,950	39,000	8,385	6,695	8,804	7,527
33,000						36,000						39,000					
33,000	33,050	6,719	5,029	7,138	5,861	36,000	36,050	7,559	5,869	7,978	6,701	39,000	39,050	8,399	6,709	8,818	7,541
33,050	33,100	6,733	5,043	7,152	5,875	36,050	36,100	7,573	5,883	7,992	6,715	39,050	39,100	8,413	6,723	8,832	7,555
33,100	33,150	6,747	5,057	7,166	5,889	36,100	36,150	7,587	5,897	8,006	6,729	39,100	39,150	8,427	6,737	8,846	7,569
33,150	33,200	6,761	5,071	7,180	5,903	36,150	36,200	7,601	5,911	8,020	6,743	39,150	39,200	8,441	6,751	8,860	7,583
33,200	33,250	6,775	5,085	7,194	5,917	36,200	36,250	7,615	5,925	8,034	6,757	39,200	39,250	8,455	6,765	8,875	7,597
33,250	33,300	6,789	5,099	7,208	5,931	36,250	36,300	7,629	5,939	8,048	6,771	39,250	39,300	8,469	6,779	8,892	7,611
33,300	33,350	6,803	5,113	7,222	5,945	36,300	36,350	7,643	5,953	8,062	6,785	39,300	39,350	8,483	6,793	8,908	7,625
33,350	33,400	6,817	5,127	7,236	5,959	36,350	36,400	7,657	5,967	8,076	6,799	39,350	39,400	8,497	6,807	8,925	7,639
33,400	33,450	6,831	5,141	7,250	5,973	36,400	36,450	7,671	5,981	8,090	6,813	39,400	39,450	8,511	6,821	8,941	7,653
33,450	33,500	6,845	5,155	7,264	5,987	36,450	36,500	7,685	5,995	8,104	6,827	39,450	39,500	8,525	6,835	8,958	7,667
33,500	33,550	6,859	5,169	7,278	6,001	36,500	36,550	7,699	6,009	8,118	6,841	39,500	39,550	8,539	6,849	8,974	7,681
33,550	33,600	6,873	5,183	7,292	6,015	36,550	36,600	7,713	6,023	8,132	6,855	39,550	39,600	8,553	6,863	8,991	7,695
33,600	33,650	6,887	5,197	7,306	6,029	36,600	36,650	7,727	6,037	8,146	6,869	39,600	39,650	8,567	6,877	9,007	7,709
33,650	33,700	6,901	5,211	7,320	6,043	36,650	36,700	7,741	6,051	8,160	6,883	39,650	39,700	8,581	6,891	9,024	7,723
33,700	33,750	6,915	5,225	7,334	6,057	36,700	36,750	7,755	6,065	8,174	6,897	39,700	39,750	8,595	6,905	9,040	7,737
33,750	33,800	6,929	5,239	7,348	6,071	36,750	36,800	7,769	6,079	8,188	6,911	39,750	39,800	8,609	6,919	9,057	7,751
33,800	33,850	6,943	5,253	7,362	6,085	36,800	36,850	7,783	6,093	8,202	6,925	39,800	39,850	8,623	6,933	9,073	7,765
33,850	33,900	6,957	5,267	7,376	6,099	36,850	36,900	7,797	6,107	8,216	6,939	39,850	39,900	8,637	6,947	9,090	7,779
33,900	33,950	6,971	5,281	7,390	6,113	36,900	36,950	7,811	6,121	8,230	6,953	39,900	39,950	8,651	6,961	9,106	7,793
33,950	34,000	6,985	5,295	7,404	6,127	36,950	37,000	7,825	6,135	8,244	6,967	39,950	40,000	8,665	6,975	9,123	7,807
34,000						37,000						40,000					
34,000	34,050	6,999	5,309	7,418	6,141	37,000	37,050	7,839	6,149	8,258	6,981	40,000	40,050	8,679	6,989	9,139	7,821
34,050	34,100	7,013	5,323	7,432	6,155	37,050	37,100	7,853	6,163	8,272	6,995	40,050	40,100	8,693	7,003	9,156	7,835
34,100	34,150	7,027	5,337	7,446	6,169	37,100	37,150	7,867	6,177	8,286	7,009	40,100	40,150	8,707	7,017	9,172	7,849
34,150	34,200	7,041	5,351	7,460	6,183	37,150	37,200	7,881	6,191	8,300	7,023	40,150	40,200	8,721	7,031	9,189	7,863
34,200	34,250	7,055	5,365	7,474	6,197	37,200	37,250	7,895	6,205	8,314	7,037	40,200	40,250	8,735	7,045	9,205	7,877
34,250	34,300	7,069	5,379	7,488	6,211	37,250	37,300	7,909	6,219	8,328	7,051	40,250	40,300	8,749	7,059	9,222	7,891
34,300	34,350	7,083	5,393	7,502	6,225	37,300	37,350	7,923	6,233	8,342	7,065	40,300	40,350	8,763	7,073	9,238	7,905
34,350	34,400	7,097	5,407	7,516	6,239	37,350	37,400	7,937	6,247	8,356	7,079	40,350	40,400	8,777	7,087	9,255	7,919
34,400	34,450	7,111	5,421	7,530	6,253	37,400	37,450	7,951	6,261	8,370	7,093	40,400	40,450	8,791	7,101	9,271	7,933
34,450	34,500	7,125	5,435	7,544	6,267	37,450	37,500	7,965	6,275	8,384	7,107	40,450	40,500	8,805	7,115	9,288	7,947
34,500	34,550	7,139	5,449	7,558	6,281	37,500	37,550	7,979	6,289	8,398	7,121	40,500	40,550	8,819	7,129	9,304	7,961
34,550	34,600	7,153	5,463	7,572	6,295	37,550	37,600	7,993	6,303	8,412	7,135	40,550	40,600	8,833	7,143	9,321	7,975
34,600	34,650	7,167	5,477	7,586	6,309	37,600	37,650	8,007	6,317	8,426	7,149	40,600	40,650	8,847	7,157	9,337	7,989
34,650	34,700	7,181	5,491	7,600	6,323	37,650	37,700	8,021	6,331	8,440	7,163	40,650	40,700	8,861	7,171	9,354	8,003
34,700	34,750	7,195	5,505	7,614	6,337	37,700	37,750	8,035	6,345	8,454	7,177	40,700	40,750	8,875	7,185	9,370	8,017
34,750	34,800	7,209	5,519	7,628	6,351	37,750	37,800	8,049	6,359	8,468	7,191	40,750	40,800	8,889	7,199	9,387	8,031
34,800	34,850	7,223	5,533	7,642	6,365	37,800	37,850	8,063	6,373	8,482	7,205	40,800	40,850	8,903	7,213	9,403	8,045
34,850	34,900	7,237	5,547	7,656	6,379	37,850	37,900	8,077	6,387	8,496	7,219	40,850	40,900	8,917	7,227	9,420	8,059
34,900	34,950	7,251	5,561	7,670	6,393	37,900	37,950	8,091	6,401	8,510	7,233	40,900	40,950	8,931	7,241	9,436	8,073
34,950	35,000	7,265	5,575	7,684	6,407	37,950	38,000	8,105	6,415	8,524	7,247	40,950	41,000	8,945	7,255	9,453	8,087

* This column must also be used by a qualifying widow(er).

Continued on next page

1990 Tax Table—*Continued*

If line 5 (Form 1040EZ), line 22 (Form 1040A), or line 37 (Form 1040) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
41,000					
41,000	41,050	8,959	7,269	9,469	8,101
41,050	41,100	8,973	7,283	9,486	8,115
41,100	41,150	8,987	7,297	9,502	8,129
41,150	41,200	9,001	7,311	9,519	8,143
41,200	41,250	9,015	7,325	9,535	8,157
41,250	41,300	9,029	7,339	9,552	8,171
41,300	41,350	9,043	7,353	9,568	8,185
41,350	41,400	9,057	7,367	9,585	8,199
41,400	41,450	9,071	7,381	9,601	8,213
41,450	41,500	9,085	7,395	9,618	8,227
41,500	41,550	9,099	7,409	9,634	8,241
41,550	41,600	9,113	7,423	9,651	8,255
41,600	41,650	9,127	7,437	9,667	8,269
41,650	41,700	9,141	7,451	9,684	8,283
41,700	41,750	9,155	7,465	9,700	8,297
41,750	41,800	9,169	7,479	9,717	8,311
41,800	41,850	9,183	7,493	9,733	8,325
41,850	41,900	9,197	7,507	9,750	8,339
41,900	41,950	9,211	7,521	9,766	8,353
41,950	42,000	9,225	7,535	9,783	8,367
42,000					
42,000	42,050	9,239	7,549	9,799	8,381
42,050	42,100	9,253	7,563	9,816	8,395
42,100	42,150	9,267	7,577	9,832	8,409
42,150	42,200	9,281	7,591	9,849	8,423
42,200	42,250	9,295	7,605	9,865	8,437
42,250	42,300	9,309	7,619	9,882	8,451
42,300	42,350	9,323	7,633	9,898	8,465
42,350	42,400	9,337	7,647	9,915	8,479
42,400	42,450	9,351	7,661	9,931	8,493
42,450	42,500	9,365	7,675	9,948	8,507
42,500	42,550	9,379	7,689	9,964	8,521
42,550	42,600	9,393	7,703	9,981	8,535
42,600	42,650	9,407	7,717	9,997	8,549
42,650	42,700	9,421	7,731	10,014	8,563
42,700	42,750	9,435	7,745	10,030	8,577
42,750	42,800	9,449	7,759	10,047	8,591
42,800	42,850	9,463	7,773	10,063	8,605
42,850	42,900	9,477	7,787	10,080	8,619
42,900	42,950	9,491	7,801	10,096	8,633
42,950	43,000	9,505	7,815	10,113	8,647
43,000					
43,000	43,050	9,519	7,829	10,129	8,661
43,050	43,100	9,533	7,843	10,146	8,675
43,100	43,150	9,547	7,857	10,162	8,689
43,150	43,200	9,561	7,871	10,179	8,703
43,200	43,250	9,575	7,885	10,195	8,717
43,250	43,300	9,589	7,899	10,212	8,731
43,300	43,350	9,603	7,913	10,228	8,745
43,350	43,400	9,617	7,927	10,245	8,759
43,400	43,450	9,631	7,941	10,261	8,773
43,450	43,500	9,645	7,955	10,278	8,787
43,500	43,550	9,659	7,969	10,294	8,801
43,550	43,600	9,673	7,983	10,311	8,815
43,600	43,650	9,687	7,997	10,327	8,829
43,650	43,700	9,701	8,011	10,344	8,843
43,700	43,750	9,715	8,025	10,360	8,857
43,750	43,800	9,729	8,039	10,377	8,871
43,800	43,850	9,743	8,053	10,393	8,885
43,850	43,900	9,757	8,067	10,410	8,899
43,900	43,950	9,771	8,081	10,426	8,913
43,950	44,000	9,785	8,095	10,443	8,927
44,000					
44,000	44,050	9,799	8,109	10,459	8,941
44,050	44,100	9,813	8,123	10,476	8,955
44,100	44,150	9,827	8,137	10,492	8,969
44,150	44,200	9,841	8,151	10,509	8,983
44,200	44,250	9,855	8,165	10,525	8,997
44,250	44,300	9,869	8,179	10,542	9,011
44,300	44,350	9,883	8,193	10,558	9,025
44,350	44,400	9,897	8,207	10,575	9,039
44,400	44,450	9,911	8,221	10,591	9,053
44,450	44,500	9,925	8,235	10,608	9,067
44,500	44,550	9,939	8,249	10,624	9,081
44,550	44,600	9,953	8,263	10,641	9,095
44,600	44,650	9,967	8,277	10,657	9,109
44,650	44,700	9,981	8,291	10,674	9,123
44,700	44,750	9,995	8,305	10,690	9,137
44,750	44,800	10,009	8,319	10,707	9,151
44,800	44,850	10,023	8,333	10,723	9,165
44,850	44,900	10,037	8,347	10,740	9,179
44,900	44,950	10,051	8,361	10,756	9,193
44,950	45,000	10,065	8,375	10,773	9,207
45,000					
45,000	45,050	10,079	8,389	10,789	9,221
45,050	45,100	10,093	8,403	10,806	9,235
45,100	45,150	10,107	8,417	10,822	9,249
45,150	45,200	10,121	8,431	10,839	9,263
45,200	45,250	10,135	8,445	10,855	9,277
45,250	45,300	10,149	8,459	10,872	9,291
45,300	45,350	10,163	8,473	10,888	9,305
45,350	45,400	10,177	8,487	10,905	9,319
45,400	45,450	10,191	8,501	10,921	9,333
45,450	45,500	10,205	8,515	10,938	9,347
45,500	45,550	10,219	8,529	10,954	9,361
45,550	45,600	10,233	8,543	10,971	9,375
45,600	45,650	10,247	8,557	10,987	9,389
45,650	45,700	10,261	8,571	11,004	9,403
45,700	45,750	10,275	8,585	11,020	9,417
45,750	45,800	10,289	8,599	11,037	9,431
45,800	45,850	10,303	8,613	11,053	9,445
45,850	45,900	10,317	8,627	11,070	9,459
45,900	45,950	10,331	8,641	11,086	9,473
45,950	46,000	10,345	8,655	11,103	9,487
46,000					
46,000	46,050	10,359	8,669	11,119	9,501
46,050	46,100	10,373	8,683	11,136	9,515
46,100	46,150	10,387	8,697	11,152	9,529
46,150	46,200	10,401	8,711	11,169	9,543
46,200	46,250	10,415	8,725	11,185	9,557
46,250	46,300	10,429	8,739	11,202	9,571
46,300	46,350	10,443	8,753	11,218	9,585
46,350	46,400	10,457	8,767	11,235	9,599
46,400	46,450	10,471	8,781	11,251	9,613
46,450	46,500	10,485	8,795	11,268	9,627
46,500	46,550	10,499	8,809	11,284	9,641
46,550	46,600	10,513	8,823	11,301	9,655
46,600	46,650	10,527	8,837	11,317	9,669
46,650	46,700	10,541	8,851	11,334	9,683
46,700	46,750	10,555	8,865	11,350	9,697
46,750	46,800	10,569	8,879	11,367	9,711
46,800	46,850	10,583	8,893	11,383	9,725
46,850	46,900	10,597	8,907	11,400	9,739
46,900	46,950	10,611	8,921	11,416	9,753
46,950	47,000	10,625	8,935	11,433	9,767
47,000					
47,000	47,050	10,639	8,949	11,449	9,781
47,050	47,100	10,654	8,963	11,466	9,795
47,100	47,150	10,670	8,977	11,482	9,809
47,150	47,200	10,687	8,991	11,499	9,823
47,200	47,250	10,703	9,005	11,515	9,837
47,250	47,300	10,720	9,019	11,532	9,851
47,300	47,350	10,736	9,033	11,548	9,865
47,350	47,400	10,753	9,047	11,565	9,879
47,400	47,450	10,769	9,061	11,581	9,893
47,450	47,500	10,786	9,075	11,598	9,907
47,500	47,550	10,802	9,089	11,614	9,921
47,550	47,600	10,819	9,103	11,631	9,935
47,600	47,650	10,835	9,117	11,647	9,949
47,650	47,700	10,852	9,131	11,664	9,963
47,700	47,750	10,868	9,145	11,680	9,977
47,750	47,800	10,885	9,159	11,697	9,991
47,800	47,850	10,901	9,173	11,713	10,005
47,850	47,900	10,918	9,187	11,730	10,019
47,900	47,950	10,934	9,201	11,746	10,033
47,950	48,000	10,951	9,215	11,763	10,047
48,000					
48,000	48,050	10,967	9,229	11,779	10,061
48,050	48,100	10,984	9,243	11,796	10,075
48,100	48,150	11,000	9,257	11,812	10,089
48,150	48,200	11,017	9,271	11,829	10,103
48,200	48,250	11,033	9,285	11,845	10,117
48,250	48,300	11,050	9,299	11,862	10,131
48,300	48,350	11,066	9,313	11,878	10,145
48,350	48,400	11,083	9,327	11,895	10,159
48,400	48,450	11,099	9,341	11,911	10,173
48,450	48,500	11,116	9,355	11,928	10,187
48,500	48,550	11,132	9,369	11,944	10,201
48,550	48,600	11,149	9,383	11,961	10,215
48,600	48,650	11,165	9,397	11,977	10,229
48,650	48,700	11,182	9,411	11,994	10,243
48,700	48,750	11,198	9,425	12,010	10,257
48,750	48,800	11,215	9,439	12,027	10,271
48,800	48,850	11,231	9,453	12,043	10,285
48,850	48,900	11,248	9,467	12,060	10,299
48,900	48,950	11,264	9,481	12,076	10,313
48,950	49,000	11,281	9,495	12,093	10,327
49,000					
49,000	49,050	11,297	9,509	12,109	10,341
49,050	49,100	11,314	9,523	12,126	10,355
49,100	49,150	11,330	9,537	12,142	10,369
49,150	49,200	11,347	9,551	12,159	10,383
49,200	49,250	11,363	9,565	12,175	10,397
49,250	49,300	11,380	9,579	12,192	10,411
49,300	49,350	11,396	9,593	12,208	10,425
49,350	49,400	11,413	9,607	12,225	10,439
49,400	49,450	11,429	9,621	12,241	10,453
49,450	49,500	11,446	9,635	12,258	10,467
49,500	49,550	11,462	9,649	12,274	10,481
49,550	49,600	11,479	9,663	12,291	10,495
49,600	49,650	11,495	9,677	12,307	10,509
49,650	49,700	11,512	9,691	12,324	10,523
49,700	49,750	11,528	9,705	12,340	10,537
49,750	49,800	11,545	9,719	12,357	10,551
49,800	49,850	11,561	9,733	12,373	10,565
49,850	49,900	11,578	9,747	12,390	10,579
49,900	49,950	11,594	9,761	12,406	10,593
49,950	50,000	11,611	9,775	12,423	10,607

* This column must also be used by a qualifying widow(er).

50,000 or over—use tax rate schedules

1990 Tax Rate Schedules

Caution: Use ONLY if your taxable income (Form 1040, line 37) is $50,000 or more. If less, use the **Tax Table.**

Schedule X—Use if your filing status is **Single**

If the amount on Form 1040, line 37, is: Over—	But not over—	Enter on Form 1040, line 38	of the amount over—
$0	$19,450	.....15%	$0
19,450	47,050	$2,917.50 + 28%	19,450
47,050	97,620	10,645.50 + 33%	47,050
97,620	.....	Use **Worksheet** below to figure your tax.	

Schedule Z—Use if your filing status is **Head of household**

If the amount on Form 1040, line 37, is: Over—	But not over—	Enter on Form 1040, line 38	of the amount over—
$0	$26,050	.....15%	$0
26,050	67,200	$3,907.50 + 28%	26,050
67,200	134,930	15,429.50 + 33%	67,200
134,930	.....	Use **Worksheet** below to figure your tax.	

Schedule Y-1—Use if your filing status is **Married filing jointly or Qualifying widow(er)**

If the amount on Form 1040, line 37, is: Over—	But not over—	Enter on Form 1040, line 38	of the amount over—
$0	$32,450	.....15%	$0
32,450	78,400	$4,867.50 + 28%	32,450
78,400	162,770	17,733.50 + 33%	78,400
162,770	.....	Use **Worksheet** below to figure your tax.	

Schedule Y-2—Use if your filing status is **Married filing separately**

If the amount on Form 1040, line 37, is: Over—	But not over—	Enter on Form 1040, line 38	of the amount over—
$0	$16,225	.....15%	$0
16,225	39,200	$2,433.75 + 28%	16,225
39,200	123,570	8,866.75 + 33%	39,200
123,570	.....	Use **Worksheet** below to figure your tax.	

Worksheet (Keep for your records)

1. If your filing status is: Single, enter $27,333.60; Head of household, enter $37,780.40; Married filing jointly or Qualifying widow(er), enter $45,575.60; Married filing separately, enter $36,708.85 . . . . . 1. _____
2. Enter your taxable income from Form 1040, line 37 . . . . . 2. _____
3. If your filing status is: Single, enter $97,620; Head of household, enter $134,930; Married filing jointly or Qualifying widow(er), enter $162,770; Married filing separately, enter $123,570 . . . . 3. _____
4. Subtract line 3 from line 2. Enter the result. (If the result is zero or less, use the schedule above for your filing status to figure your tax. DO NOT use this worksheet.) 4. _____
5. Multiply the amount on line 4 by 28% (.28). Enter the result . . . . . 5. _____
6. Multiply the amount on line 4 by 5% (.05). Enter the result . . . . . 6. _____
7. Multiply $574 by the number of exemptions claimed on Form 1040, line 6e. (If married filing separately, see the **Note** below.) Enter the result . . . . . 7. _____
8. Compare the amounts on lines 6 and 7. Enter the **smaller** of the two amounts here . . . . . 8. _____
9. **Tax.** Add lines 1, 5, and 8. Enter the total here and on Form 1040, line 38 . . . . . 9. _____

Note: *If married filing separately and you did* ***not*** *claim an exemption for your spouse, multiply $574 by the number of exemptions claimed on Form 1040, line 6e. Add $574 to the result and enter the total on line 7 above.*

1990 Earned Income Credit Table

Caution: *This Is Not A Tax Table*

To find your earned income credit: Read down the column titled "If line 5 or 6 of the worksheet is—" and find the appropriate amount from the Earned Income Credit Worksheet in Chapter 35. Read across to the right and find the amount of the earned income credit. Enter that amount on line 7 or 8 of the worksheet, whichever applies.

If line 5 or 6 of the worksheet is—		Your earned income credit is—	If line 5 or 6 of the worksheet is—		Your earned income credit is—	If line 5 or 6 of the worksheet is—		Your earned income credit is—	If line 5 or 6 of the worksheet is—		Your earned income credit is—	If line 5 or 6 of the worksheet is—		Your earned income credit is—
At least	But less than		At least	But less than		At least	But less than		At least	But less than		At least	But less than	
$1	$25	$2	$1,600	$1,625	$226	$3,200	$3,225	$450	$4,800	$4,825	$674	$6,400	$6,425	$898
25	50	5	1,625	1,650	229	3,225	3,250	453	4,825	4,850	677	6,425	6,450	901
50	75	9	1,650	1,675	233	3,250	3,275	457	4,850	4,875	681	6,450	6,475	905
75	100	12	1,675	1,700	236	3,275	3,300	460	4,875	4,900	684	6,475	6,500	908
100	125	16	1,700	1,725	240	3,300	3,325	464	4,900	4,925	688	6,500	6,525	912
125	150	19	1,725	1,750	243	3,325	3,350	467	4,925	4,950	691	6,525	6,550	915
150	175	23	1,750	1,775	247	3,350	3,375	471	4,950	4,975	695	6,550	6,575	919
175	200	26	1,775	1,800	250	3,375	3,400	474	4,975	5,000	698	6,575	6,600	922
200	225	30	1,800	1,825	254	3,400	3,425	478	5,000	5,025	702	6,600	6,625	926
225	250	33	1,825	1,850	257	3,425	3,450	481	5,025	5,050	705	6,625	6,650	929
250	275	37	1,850	1,875	261	3,450	3,475	485	5,050	5,075	709	6,650	6,675	933
275	300	40	1,875	1,900	264	3,475	3,500	488	5,075	5,100	712	6,675	6,700	936
300	325	44	1,900	1,925	268	3,500	3,525	492	5,100	5,125	716	6,700	6,725	940
325	350	47	1,925	1,950	271	3,525	3,550	495	5,125	5,150	719	6,725	6,750	943
350	375	51	1,950	1,975	275	3,550	3,575	499	5,150	5,175	723	6,750	6,775	947
375	400	54	1,975	2,000	278	3,575	3,600	502	5,175	5,200	726	6,775	6,800	950
400	425	58	2,000	2,025	282	3,600	3,625	506	5,200	5,225	730	6,800	10,750	953
425	450	61	2,025	2,050	285	3,625	3,650	509	5,225	5,250	733	10,750	10,775	950
450	475	65	2,050	2,075	289	3,650	3,675	513	5,250	5,275	737	10,775	10,800	948
475	500	68	2,075	2,100	292	3,675	3,700	516	5,275	5,300	740	10,800	10,825	945
500	525	72	2,100	2,125	296	3,700	3,725	520	5,300	5,325	744	10,825	10,850	943
525	550	75	2,125	2,150	299	3,725	3,750	523	5,325	5,350	747	10,850	10,875	940
550	575	79	2,150	2,175	303	3,750	3,775	527	5,350	5,375	751	10,875	10,900	938
575	600	82	2,175	2,200	306	3,775	3,800	530	5,375	5,400	754	10,900	10,925	935
600	625	86	2,200	2,225	310	3,800	3,825	534	5,400	5,425	758	10,925	10,950	933
625	650	89	2,225	2,250	313	3,825	3,850	537	5,425	5,450	761	10,950	10,975	930
650	675	93	2,250	2,275	317	3,850	3,875	541	5,450	5,475	765	10,975	11,000	928
675	700	96	2,275	2,300	320	3,875	3,900	544	5,475	5,500	768	11,000	11,025	925
700	725	100	2,300	2,325	324	3,900	3,925	548	5,500	5,525	772	11,025	11,050	923
725	750	103	2,325	2,350	327	3,925	3,950	551	5,525	5,550	775	11,050	11,075	920
750	775	107	2,350	2,375	331	3,950	3,975	555	5,550	5,575	779	11,075	11,100	918
775	800	110	2,375	2,400	334	3,975	4,000	558	5,575	5,600	782	11,100	11,125	915
800	825	114	2,400	2,425	338	4,000	4,025	562	5,600	5,625	786	11,125	11,150	913
825	850	117	2,425	2,450	341	4,025	4,050	565	5,625	5,650	789	11,150	11,175	910
850	875	121	2,450	2,475	345	4,050	4,075	569	5,650	5,675	793	11,175	11,200	908
875	900	124	2,475	2,500	348	4,075	4,100	572	5,675	5,700	796	11,200	11,225	905
900	925	128	2,500	2,525	352	4,100	4,125	576	5,700	5,725	800	11,225	11,250	903
925	950	131	2,525	2,550	355	4,125	4,150	579	5,725	5,750	803	11,250	11,275	900
950	975	135	2,550	2,575	359	4,150	4,175	583	5,750	5,775	807	11,275	11,300	898
975	1,000	138	2,575	2,600	362	4,175	4,200	586	5,775	5,800	810	11,300	11,325	895
1,000	1,025	142	2,600	2,625	366	4,200	4,225	590	5,800	5,825	814	11,325	11,350	893
1,025	1,050	145	2,625	2,650	369	4,225	4,250	593	5,825	5,850	817	11,350	11,375	890
1,050	1,075	149	2,650	2,675	373	4,250	4,275	597	5,850	5,875	821	11,375	11,400	888
1,075	1,100	152	2,675	2,700	376	4,275	4,300	600	5,875	5,900	824	11,400	11,425	885
1,100	1,125	156	2,700	2,725	380	4,300	4,325	604	5,900	5,925	828	11,425	11,450	883
1,125	1,150	159	2,725	2,750	383	4,325	4,350	607	5,925	5,950	831	11,450	11,475	880
1,150	1,175	163	2,750	2,775	387	4,350	4,375	611	5,950	5,975	835	11,475	11,500	878
1,175	1,200	166	2,775	2,800	390	4,375	4,400	614	5,975	6,000	838	11,500	11,525	875
1,200	1,225	170	2,800	2,825	394	4,400	4,425	618	6,000	6,025	842	11,525	11,550	873
1,225	1,250	173	2,825	2,850	397	4,425	4,450	621	6,025	6,050	845	11,550	11,575	870
1,250	1,275	177	2,850	2,875	401	4,450	4,475	625	6,050	6,075	849	11,575	11,600	868
1,275	1,300	180	2,875	2,900	404	4,475	4,500	628	6,075	6,100	852	11,600	11,625	865
1,300	1,325	184	2,900	2,925	408	4,500	4,525	632	6,100	6,125	856	11,625	11,650	863
1,325	1,350	187	2,925	2,950	411	4,525	4,550	635	6,125	6,150	859	11,650	11,675	860
1,350	1,375	191	2,950	2,975	415	4,550	4,575	639	6,150	6,175	863	11,675	11,700	858
1,375	1,400	194	2,975	3,000	418	4,575	4,600	642	6,175	6,200	866	11,700	11,725	855
1,400	1,425	198	3,000	3,025	422	4,600	4,625	646	6,200	6,225	870	11,725	11,750	853
1,425	1,450	201	3,025	3,050	425	4,625	4,650	649	6,225	6,250	873	11,750	11,775	850
1,450	1,475	205	3,050	3,075	429	4,650	4,675	653	6,250	6,275	877	11,775	11,800	848
1,475	1,500	208	3,075	3,100	432	4,675	4,700	656	6,275	6,300	880	11,800	11,825	845
1,500	1,525	212	3,100	3,125	436	4,700	4,725	660	6,300	6,325	884	11,825	11,850	843
1,525	1,550	215	3,125	3,150	439	4,725	4,750	663	6,325	6,350	887	11,850	11,875	840
1,550	1,575	219	3,150	3,175	443	4,750	4,775	667	6,350	6,375	891	11,875	11,900	838
1,575	1,600	222	3,175	3,200	446	4,775	4,800	670	6,375	6,400	894	11,900	11,925	835

1990 Earned Income Credit Table *(continued)* **Caution:** *This is Not a Tax Table*

If line 5 or 6 of the worksheet is— At least	But less than	Your earned income credit is—
$11,925	$11,950	$833
11,950	11,975	830
11,975	12,000	828
12,000	12,025	825
12,025	12,050	823
12,050	12,075	820
12,075	12,100	818
12,100	12,125	815
12,125	12,150	813
12,150	12,175	810
12,175	12,200	808
12,200	12,225	805
12,225	12,250	803
12,250	12,275	800
12,275	12,300	798
12,300	12,325	795
12,325	12,350	793
12,350	12,375	790
12,375	12,400	788
12,400	12,425	785
12,425	12,450	783
12,450	12,475	780
12,475	12,500	778
12,500	12,525	775
12,525	12,550	773
12,550	12,575	770
12,575	12,600	768
12,600	12,625	765
12,625	12,650	763
12,650	12,675	760
12,675	12,700	758
12,700	12,725	755
12,725	12,750	753
12,750	12,775	750
12,775	12,800	748
12,800	12,825	745
12,825	12,850	743
12,850	12,875	740
12,875	12,900	738
12,900	12,925	735
12,925	12,950	733
12,950	12,975	730
12,975	13,000	728
13,000	13,025	725
13,025	13,050	723
13,050	13,075	720
13,075	13,100	718
13,100	13,125	715
13,125	13,150	713
13,150	13,175	710
13,175	13,200	708
13,200	13,225	705
13,225	13,250	703
13,250	13,275	700
13,275	13,300	698
13,300	13,325	695
13,325	13,350	693
13,350	13,375	690
13,375	13,400	688
13,400	13,425	685
13,425	13,450	683
13,450	13,475	680
13,475	13,500	678
13,500	13,525	675
13,525	13,550	673
13,550	13,575	670
13,575	13,600	668
13,600	13,625	665
$13,625	$13,650	$663
13,650	13,675	660
13,675	13,700	658
13,700	13,725	655
13,725	13,750	653
13,750	13,775	650
13,775	13,800	648
13,800	13,825	645
13,825	13,850	643
13,850	13,875	640
13,875	13,900	638
13,900	13,925	635
13,925	13,950	633
13,950	13,975	630
13,975	14,000	628
14,000	14,025	625
14,025	14,050	623
14,050	14,075	620
14,075	14,100	618
14,100	14,125	615
14,125	14,150	613
14,150	14,175	610
14,175	14,200	608
14,200	14,225	605
14,225	14,250	603
14,250	14,275	600
14,275	14,300	598
14,300	14,325	595
14,325	14,350	593
14,350	14,375	590
14,375	14,400	588
14,400	14,425	585
14,425	14,450	583
14,450	14,475	580
14,475	14,500	578
14,500	14,525	575
14,525	14,550	573
14,550	14,575	570
14,575	14,600	568
14,600	14,625	565
14,625	14,650	563
14,650	14,675	560
14,675	14,700	558
14,700	14,725	555
14,725	14,750	553
14,750	14,775	550
14,775	14,800	548
14,800	14,825	545
14,825	14,850	543
14,850	14,875	540
14,875	14,900	538
14,900	14,925	535
14,925	14,950	533
14,950	14,975	530
14,975	15,000	528
15,000	15,025	525
15,025	15,050	523
15,050	15,075	520
15,075	15,100	518
15,100	15,125	515
15,125	15,150	513
15,150	15,175	510
15,175	15,200	508
15,200	15,225	505
15,225	15,250	503
15,250	15,275	500
15,275	15,300	498
15,300	15,325	495
$15,325	$15,350	$493
15,350	15,375	490
15,375	15,400	488
15,400	15,425	485
15,425	15,450	483
15,450	15,475	480
15,475	15,500	478
15,500	15,525	475
15,525	15,550	473
15,550	15,575	470
15,575	15,600	468
15,600	15,625	465
15,625	15,650	463
15,650	15,675	460
15,675	15,700	458
15,700	15,725	455
15,725	15,750	453
15,750	15,775	450
15,775	15,800	448
15,800	15,825	445
15,825	15,850	443
15,850	15,875	440
15,875	15,900	438
15,900	15,925	435
15,925	15,950	433
15,950	15,975	430
15,975	16,000	428
16,000	16,025	425
16,025	16,050	423
16,050	16,075	420
16,075	16,100	418
16,100	16,125	415
16,125	16,150	413
16,150	16,175	410
16,175	16,200	408
16,200	16,225	405
16,225	16,250	403
16,250	16,275	400
16,275	16,300	398
16,300	16,325	395
16,325	16,350	393
16,350	16,375	390
16,375	16,400	388
16,400	16,425	385
16,425	16,450	383
16,450	16,475	380
16,475	16,500	378
16,500	16,525	375
16,525	16,550	373
16,550	16,575	370
16,575	16,600	368
16,600	16,625	365
16,625	16,650	363
16,650	16,675	360
16,675	16,700	358
16,700	16,725	355
16,725	16,750	353
16,750	16,775	350
16,775	16,800	348
16,800	16,825	345
16,825	16,850	343
16,850	16,875	340
16,875	16,900	338
16,900	16,925	335
16,925	16,950	333
16,950	16,975	330
16,975	17,000	328
17,000	17,025	325
$17,025	$17,050	$323
17,050	17,075	320
17,075	17,100	318
17,100	17,125	315
17,125	17,150	313
17,150	17,175	310
17,175	17,200	308
17,200	17,225	305
17,225	17,250	303
17,250	17,275	300
17,275	17,300	298
17,300	17,325	295
17,325	17,350	293
17,350	17,375	290
17,375	17,400	288
17,400	17,425	285
17,425	17,450	283
17,450	17,475	280
17,475	17,500	278
17,500	17,525	275
17,525	17,550	273
17,550	17,575	270
17,575	17,600	268
17,600	17,625	265
17,625	17,650	263
17,650	17,675	260
17,675	17,700	258
17,700	17,725	255
17,725	17,750	253
17,750	17,775	250
17,775	17,800	248
17,800	17,825	245
17,825	17,850	243
17,850	17,875	240
17,875	17,900	238
17,900	17,925	235
17,925	17,950	233
17,950	17,975	230
17,975	18,000	228
18,000	18,025	225
18,025	18,050	223
18,050	18,075	220
18,075	18,100	218
18,100	18,125	215
18,125	18,150	213
18,150	18,175	210
18,175	18,200	208
18,200	18,225	205
18,225	18,250	203
18,250	18,275	200
18,275	18,300	198
18,300	18,325	195
18,325	18,350	193
18,350	18,375	190
18,375	18,400	188
18,400	18,425	185
18,425	18,450	183
18,450	18,475	180
18,475	18,500	178
18,500	18,525	175
18,525	18,550	173
18,550	18,575	170
18,575	18,600	168
18,600	18,625	165
18,625	18,650	163
18,650	18,675	160
18,675	18,700	158
18,700	18,725	155
$18,725	$18,750	$153
18,750	18,775	150
18,775	18,800	148
18,800	18,825	145
18,825	18,850	143
18,850	18,875	140
18,875	18,900	138
18,900	18,925	135
18,925	18,950	133
18,950	18,975	130
18,975	19,000	128
19,000	19,025	125
19,025	19,050	123
19,050	19,075	120
19,075	19,100	118
19,100	19,125	115
19,125	19,150	113
19,150	19,175	110
19,175	19,200	108
19,200	19,225	105
19,225	19,250	103
19,250	19,275	100
19,275	19,300	98
19,300	19,325	95
19,325	19,350	93
19,350	19,375	90
19,375	19,400	88
19,400	19,425	85
19,425	19,450	83
19,450	19,475	80
19,475	19,500	78
19,500	19,525	75
19,525	19,550	73
19,550	19,575	70
19,575	19,600	68
19,600	19,625	65
19,625	19,650	63
19,650	19,675	60
19,675	19,700	58
19,700	19,725	55
19,725	19,750	53
19,750	19,775	50
19,775	19,800	48
19,800	19,825	45
19,825	19,850	43
19,850	19,875	40
19,875	19,900	38
19,900	19,925	35
19,925	19,950	33
19,950	19,975	30
19,975	20,000	28
20,000	20,025	25
20,025	20,050	23
20,050	20,075	20
20,075	20,100	18
20,100	20,125	15
20,125	20,150	13
20,150	20,175	10
20,175	20,200	8
20,200	20,225	5
20,225	20,250	3
20,250	20,264	1

$20,264 or more—you cannot take the credit

What Is Tele-Tax?

Recorded Tax Information has about 140 topics of tax information that answer many Federal tax questions. You can hear up to three topics on each call you make.

Automated Refund Information is available so you can check the status of your refund.

To Call Tele-Tax Toll-Free, Use Only the Numbers Listed Below for Your Area

Long-distance charges apply if you call from outside the local dialing area of the numbers listed below. **Do not dial "1-800" when using a local number.** However, when dialing from an area that does not have a local number, be sure to dial "1-800" before calling the toll-free number. A complete list of these topics is on the next page.

How Do I Use Tele-Tax?

Recorded Tax Information

Topic numbers are effective January 1, 1991.

Push-button (tone signaling) service is available 24 hours a day, 7 days a week.

Rotary (dial)/push-button (pulse dial) service is available Monday through Friday during regular office hours. (In Hawaii, from 6:30 A.M. to 1:00 P.M.)

Select, by number, the topic you want to hear. For the directory of topics, listen to topic no. 323.

Have paper and pencil handy to take notes.

Call the appropriate phone number listed below.

- If you have a push-button (tone signaling) phone, immediately follow the recorded instructions, or
- If you have a rotary (dial) or push-button (pulse dial) phone, wait for further recorded instructions.

Automated Refund Information

Be sure to have a copy of your tax return available since you will need to know the first social security number shown on your return, the filing status, and the **exact** amount of your refund.

Then, call the appropriate phone number listed below and follow the recorded instructions.

IRS updates refund information every 7 days. If you call to find out about the status of your refund and do not receive a refund mailing date, please wait 7 days before calling back.

- Push-button (tone signaling) service is available Monday through Friday from 7:00 A.M. to 11:30 P.M. (Hours may vary in your area.)
- Rotary (dial) / push-button (pulse dial) service is available Monday through Friday during regular office hours. (In Hawaii, from 6:30 A.M. to 1:00 P.M.)

ALABAMA
1-800-829-4477

ALASKA
1-800-829-4477

ARIZONA
Phoenix, 252-4909
Elsewhere,
1-800-829-4477

ARKANSAS
1-800-829-4477

CALIFORNIA
Counties of Amador, Calaveras, Contra Costa, Marin, and San Joaquin,
1-800-829-4032
Los Angeles, 617-3177
Oakland, 839-4245
Elsewhere,
1-800-829-4477

COLORADO
Denver, 592-1118
Elsewhere,
1-800-829-4477

CONNECTICUT
1-800-829-4477

DELAWARE
1-800-829-4477

DISTRICT of COLUMBIA
882-1040

FLORIDA
1-800-829-4477

GEORGIA
Atlanta, 331-6572
Elsewhere,
1-800-829-4477

HAWAII
1-800-829-4477

IDAHO
1-800-829-4477

ILLINOIS
Chicago, 886-9614
In area code 708,
1-312-886-9614
Springfield, 789-0489
Elsewhere,
1-800-829-4477

INDIANA
Indianapolis, 631-1010
Elsewhere,
1-800-829-4477

IOWA
Des Moines, 284-7454
Elsewhere,
1-800-829-4477

KANSAS
1-800-829-4477

KENTUCKY
1-800-829-4477

LOUISIANA
1-800-829-4477

MAINE
1-800-829-4477

MARYLAND
Baltimore, 466-1040
Elsewhere,
1-800-829-4477

MASSACHUSETTS
Boston, 523-8602
Elsewhere,
1-800-829-4477

MICHIGAN
Detroit, 961-4282
Elsewhere,
1-800-829-4477

MINNESOTA
St. Paul, 644-7748
Elsewhere,
1-800-829-4477

MISSISSIPPI
1-800-829-4477

MISSOURI
St. Louis, 241-4700
Elsewhere,
1-800-829-4477

MONTANA
1-800-829-4477

NEBRASKA
Omaha, 221-3324
Elsewhere,
1-800-829-4477

NEVADA
1-800-829-4477

NEW HAMPSHIRE
1-800-829-4477

NEW JERSEY
1-800-829-4477

NEW MEXICO
1-800-829-4477

NEW YORK
Bronx, 406-4080
Brooklyn, 858-4461
Buffalo, 856-9320
Manhattan, 406-4080
Queens, 858-4461
Staten Island, 858-4461
Elsewhere,
1-800-829-4477

NORTH CAROLINA
1-800-829-4477

NORTH DAKOTA
1-800-829-4477

OHIO
Cincinnati, 421-0329
Cleveland, 522-3037
Elsewhere,
1-800-829-4477

OKLAHOMA
1-800-829-4477

OREGON
Portland, 294-5363
Elsewhere,
1-800-829-4477

PENNSYLVANIA
Philadelphia, 627-1040
Pittsburgh, 261-1040
Elsewhere,
1-800-829-4477

PUERTO RICO
1-800-829-4477

RHODE ISLAND
1-800-829-4477

SOUTH CAROLINA
1-800-829-4477

SOUTH DAKOTA
1-800-829-4477

TENNESSEE
Nashville, 242-1541
Elsewhere,
1-800-829-4477

TEXAS
Dallas, 767-1792
Houston, 850-8801
Elsewhere,
1-800-829-4477

UTAH
1-800-829-4477

VERMONT
1-800-829-4477

VIRGINIA
Richmond, 783-1569
Elsewhere,
1-800-829-4477

WASHINGTON
Seattle, 343-7221
Elsewhere,
1-800-829-4477

WEST VIRGINIA
1-800-829-4477

WISCONSIN
Milwaukee, 273-8100
Elsewhere,
1-800-829-4477

WYOMING
1-800-829-4477

Tele-Tax Topic Numbers and Subjects

Topic No.	Subject
	IRS Procedures and Services
101	IRS help available—Volunteer tax assistance programs, toll-free telephone, walk-in assistance, and outreach program
102	Tax assistance for individuals with disabilities and the hearing impaired
103	Small business tax education—Tax help for small businesses
104	Problem resolution program—Help for problem situations
105	Public libraries—Tax information tapes and reproducible tax forms
106	Examination procedures and how to prepare for an audit
107	The collection process
108	Tax fraud—How to report
109	Types of organizations that qualify for tax-exempt status
110	Organizations—How to apply for exempt status
111	Examination appeal rights
112	Electronic filing
113	Special enrollment examination to practice before IRS
114	Power of attorney information
115	Change of address—How to notify IRS
911	Hardship assistance applications
999	Local information
	Filing Requirements, Filing Status, Exemptions
151	Who must file?
152	Which form—1040, 1040A, or 1040EZ?
153	When, where, and how to file
154	What is your filing status?
155	Dependents
156	Estimated tax
157	Amended returns
158	Decedents
	Types of Income
201	Wages and salaries
202	Tips
203	Interest received
204	Dividends
205	Refund of state and local taxes
206	Alimony received
207	Business income
208	Sole proprietorship
209	Capital gains and losses
210	Pensions and annuities
211	Pensions—The general rule and the simplified general rule
212	Lump-sum distributions
213	Rental income and expenses
214	Renting vacation property/Renting to relatives
215	Royalties
216	Farming and fishing income
217	Earnings for clergy
218	Unemployment compensation
219	Gambling income and expenses
220	Bartering income
221	Scholarships, fellowships, and grants
222	Nontaxable income
223	Social security and equivalent railroad retirement benefits
224	401(k) plans
225	Passive activities—Losses/credits
226	Tax statements from the Railroad Retirement Board
	Adjustments to Income
251	Individual retirement arrangements (IRAs)
252	Alimony paid
253	Bad debt deduction
254	Tax shelters

Topic No.	Subject
	Itemized Deductions
301	Should I itemize?
302	Medical and dental expenses
303	Taxes
304	Moving expenses
305	Interest expense
306	Contributions
307	Casualty losses
308	Miscellaneous expenses
309	Business use of home
310	Business use of car
311	Business travel expenses
312	Business entertainment expenses
313	Educational expenses
314	Employee business expenses
	Tax Computation
351	Tax and credits figured by IRS
352	Self-employment tax
353	Five-year averaging for lump-sum distributions
354	Alternative minimum tax
355	Gift tax
356	Estate tax
357	Standard deduction
358	Tax on a child's investment income
	Tax Credits
401	Child care credit
402	Earned income credit
403	Credit for the elderly or the disabled
	General Information
451	Substitute tax forms
452	Highlights of 1990 tax changes
453	Refunds—How long they should take
454	Copy of your tax return—How to get one
455	Forms/Publications—How to order
456	Tax shelter registration
457	Extensions for time to file your tax return
458	Form W-2—What to do if not received
459	Penalty for underpayment of estimated tax
460	Recordkeeping
461	How to choose a tax preparer
462	Failure to pay child/spousal support and other Federal obligations
463	Withholding on interest and dividends
464	Highway use tax
465	Checklist/Common errors when preparing your tax return
466	Withholding on pensions and annuities
467	Foreign currency transactions
	IRS Notices and Letters
501	Notices—What to do
502	Notice of underreported income—CP 2000
503	IRS notices and bills/Penalty and interest charges
	Basis of Assets, Depreciation, Sale of Assets
551	Sale of your home—General
552	Sale of your home—How to report gain
553	Sale of your home—Exclusion of gain, age 55 and over
554	Basis of assets
555	Depreciation
556	Installment sales

Topic No.	Subject
	Employer Tax Information
601	Social security withholding rates
602	Form W-2—Where, when and how to file
603	Form W-4—Employee's Withholding Allowance Certificate
604	Federal tax deposits—General
605	Employer identification number—How to apply
606	Form 942—Employer's Quarterly Tax Return for Household Employees
607	Form 941—Deposit requirements
608	Form 941—Employer's Quarterly Federal Tax Return
609	Form 940—Deposit requirements
610	Form 940/940-EZ—Employer's Annual Federal Unemployment Tax Return
611	Targeted jobs credit
612	Tips—Withholding and reporting
	Magnetic Media Information
651	Who must file/originals and corrections
652	Acceptable media/Locating a third party to prepare your files
653	Applications, forms, and information
654	Waivers, extensions, and format deviations
655	Test files and combined Federal/state filing
656	Electronic filing of information returns
657	Information returns bulletin board system
	Tax Information for Aliens and U.S. Citizens Living Abroad
701	Resident and nonresident aliens
702	Dual-status alien
703	Alien tax clearance
704	Foreign earned income exclusion—General
705	Foreign earned income exclusion—Who qualifies?
706	Foreign earned income exclusion—What qualifies?
707	Foreign tax credit
	The following topics are in Spanish:
751	Who must file?
752	Which form to use?
753	What is your filing status?
754	Earned income credit
755	Highlights of 1990 tax changes
756	Forms and publications—How to order
757	Alien tax clearance
758	Refunds—How long they should take
759	IRS help available— Volunteer tax assistance programs, toll-free telephone, walk-in assistance, and outreach program
760	Social security and equivalent railroad retirement benefits
	Tax Information for Puerto Rico Residents
851	Who must file a U.S. income tax return in Puerto Rico
852	Deductions and credits for Puerto Rico filers
853	Federal employment taxes in Puerto Rico
854	Tax assistance for residents of Puerto Rico

Topic numbers are effective January 1, 1991.

Call IRS With Your Tax Question

If the instructions to the tax forms and our free tax publications have not answered your question, please call us TOLL-FREE. "Toll-Free" is a telephone call for which you pay only local charges.

CHOOSING THE RIGHT NUMBER: Use only the number listed below for your area. Use a local city number only if it is not a long distance call for you. **Please do not dial "1-800" when using a local city number.** However, when dialing from an area that does not have a local number, be sure to dial "1-800" before calling the toll-free number.

BEFORE YOU CALL: Remember that good communication is a two-way process. IRS representatives care about the quality of the service we provide to you, our customer. You can help us provide accurate, complete answers to your tax questions by having the following information available:

1. The tax form, schedule, or notice to which your question relates;
2. The facts about your particular situation (the answer to the same question often varies from one taxpayer to another because of differences in their age, income, whether they can be claimed as a dependent, etc.);
3. The name of any IRS publication or other source of information that you used to look for the answer.

BEFORE YOU HANG UP: If you do not fully understand the answer you receive, or you feel our representative may not fully understand your question, our representative needs to know this. He or she will be happy to take the additional time required to be sure we have answered your question fully and in the manner which is most helpful to you.

By law, you are responsible for paying your fair share of Federal income tax. If we should make an error in answering your question, you are still responsible for the payment of the correct tax. Should this occur, however, you will not be charged any penalty. To make sure that IRS representatives give accurate and courteous answers, a second IRS representative sometimes listens in on telephone calls. No record is kept of any taxpayer's identity.

ALABAMA
1-800-829-1040

ALASKA
Anchorage, 561-7484
Elsewhere, 1-800-829-1040

ARIZONA
Phoenix, 257-1233
Elsewhere, 1-800-829-1040

ARKANSAS
1-800-829-1040

CALIFORNIA
Oakland, 839-1040
San Francisco, 839-1040
Elsewhere, 1-800-829-1040

COLORADO
Denver, 825-7041
Elsewhere, 1-800-829-1040

CONNECTICUT
1-800-829-1040

DELAWARE
1-800-829-1040

DISTRICT of COLUMBIA
1-800-829-1040

FLORIDA
Jacksonville, 354-1760
Elsewhere, 1-800-829-1040

GEORGIA
Atlanta, 522-0050
Elsewhere, 1-800-829-1040

HAWAII
Oahu, 541-1040
Elsewhere, 1-800-829-1040

IDAHO
1-800-829-1040

ILLINOIS
Chicago, 435-1040
In area code 708,
1-312-435-1040
Elsewhere, 1-800-829-1040

INDIANA
Indianapolis, 226-5477
Elsewhere, 1-800-829-1040

IOWA
Des Moines, 283-0523
Elsewhere, 1-800-829-1040

KANSAS
1-800-829-1040

KENTUCKY
1-800-829-1040

LOUISIANA
1-800-829-1040

MAINE
1-800-829-1040

MARYLAND
Baltimore, 962-2590
Elsewhere, 1-800-829-1040

MASSACHUSETTS
Boston, 523-1040
Elsewhere, 1-800-829-1040

MICHIGAN
Detroit, 237-0800
Elsewhere, 1-800-829-1040

MINNESOTA
Minneapolis, 644-7515
St. Paul, 644-7515
Elsewhere, 1-800-829-1040

MISSISSIPPI
1-800-829-1040

MISSOURI
St. Louis, 342-1040
Elsewhere, 1-800-829-1040

MONTANA
1-800-829-1040

NEBRASKA
Omaha, 422-1500
Elsewhere, 1-800-829-1040

NEVADA
1-800-829-1040

NEW HAMPSHIRE
1-800-829-1040

NEW JERSEY
1-800-829-1040

NEW MEXICO
1-800-829-1040

NEW YORK
Bronx, 732-0100
Brooklyn, 596-3770
Buffalo, 855-3955
Manhattan, 732-0100
Nassau, 222-1131
Queens, 596-3770
Staten Island, 596-3770
Suffolk, 724-5000
Elsewhere, 1-800-829-1040

NORTH CAROLINA
1-800-829-1040

NORTH DAKOTA
1-800-829-1040

OHIO
Cincinnati, 621-6281
Cleveland, 522-3000
Elsewhere, 1-800-829-1040

OKLAHOMA
1-800-829-1040

OREGON
Portland, 221-3960
Elsewhere, 1-800-829-1040

PENNSYLVANIA
Philadelphia, 574-9900
Pittsburgh, 281-0112
Elsewhere, 1-800-829-1040

PUERTO RICO
San Juan Metro Area,
766-5040
Isla, 766-5549

RHODE ISLAND
1-800-829-1040

SOUTH CAROLINA
1-800-829-1040

SOUTH DAKOTA
1-800-829-1040

TENNESSEE
Nashville, 259-4601
Elsewhere, 1-800-829-1040

TEXAS
Dallas, 742-2440
Houston, 965-0440
Elsewhere, 1-800-829-1040

UTAH
1-800-829-1040

VERMONT
1-800-829-1040

VIRGINIA
Richmond, 649-2361
Elsewhere, 1-800-829-1040

WASHINGTON
Seattle, 442-1040
Elsewhere, 1-800-829-1040

WEST VIRGINIA
1-800-829-1040

WISCONSIN
Milwaukee, 271-3780
Elsewhere, 1-800-829-1040

WYOMING
1-800-829-1040

Telephone Assistance Services for Hearing Impaired Taxpayers Who Have Access to TDD Equipment.

Hours of Operation

8:00 A.M. to 6:45 P.M. EST (Jan. 1–April 15)

8:00 A.M. to 4:30 P.M. EST (April 16–Dec. 31)

All locations in U.S., including Alaska, Hawaii, Virgin Islands, and Puerto Rico, 1-800-829-4059

Need Additional Forms or Publications?

If you do not have any tax questions and you only need tax forms and publications, you can—

- Visit your local IRS office.
- Visit a participating bank or post office for Forms 1040, 1040A, 1040EZ, Schedules A&B, Schedules 1&2, and their related instructions.
- Visit a participating library, which stocks a wider variety of forms and publications.
- Use the handy order blank at the end of this publication. You should receive the items you order within 2 weeks from the time you mail your request.
- Call our toll-free "Forms Only" number 1-800-TAX-FORM (1-800-829-3676). The hours of operation during the filing season are **8:00 A.M. to 5:00 P.M. (weekdays)** and **9:00 A.M. to 3:00 P.M. (Saturdays).** For callers in Alaska and Hawaii, the hours are Pacific Standard Time. For callers in Puerto Rico, the hours are Eastern Standard Time. You should receive your order within 7 to 10 work days after you call.

INDEX

A

Abortion, legal.....116
Accident and health insurance.....83, 118
Accidents.....129
Accountable plans.....145
Accounting methods.....10
Accounting periods.....10
Accounting to employer.....146
ACTION volunteers.....46
Activity not for profit, income from.....77
Acupuncture.....116
Address label.....9
Address of where to file (*See Back cover*)
Adjusted basis.....85-86, 133
Adjusted gross income.....160, 161
Adoption.....20, 115, 127, 158
Advance commissions.....40
Advance earned income credit.....173, 181
Advance interest.....121
Advance rent.....61
AFDC payments (*See also* Benefit payments *under* State).....17
Age 65 or older (*See* Standard deduction)
Aliens (*See also* Nonresident aliens).....7
Alimony and separate maintenance.....108-111
  Instruments executed after 1984.....109
  Instruments executed in 1985 or 1986.....110
Alternative minimum tax.....162, 182, 183
Amended returns.....14
American citizens abroad.....7
Annuities.....69-74
Annuity contributions.....44
Appeal rights.....208
Appraisal fees.....127, 158
Armed forces:
  Bonuses.....46
  Dependency allotments.....21
  Disability pensions.....46, 74
  Home, sale of.....94
  Lump-sum payments.....46
  Moving expenses.....134
  Pay.....46
  Reservists' transportation.....139
  Service academies.....156
  Travel and transportation.....143
  Uniforms.....156
Artistic works.....91
Artists, performing.....144, 155
Assessments, improvements.....62, 85, 120
Attorney fees.....158
Audit of return (*See* Examination of return)
Automobile expenses (*See* Car expenses)
Awards, prizes.....40, 78, 81
Away from home.....140

B

Back pay.....40
Backup withholding.....32, 49, 57, 79
Bad debts.....92
Bar review course.....153
Bargain purchases.....86
Barter income.....78
Basis.....85-88
Beneficiary of:
  Deceased employee.....82
  Estate or trust.....78
Bequests (*See* Inheritances)
Blindness (*See* Standard deduction)
Bonds:
  Amortization of premium.....88, 122, 158
  Basis of.....87-88
  Issued at discount.....53-54, 91
  Original issue discount.....53
  Retirement of.....91
  Sale of.....52, 91
  Savings.....50-52
  Tax-exempt.....54, 91
Bonuses.....40
Books and records (*See* Recordkeeping)
Bribes and illegal payments.....155
Brokerage account.....10
Burglary (*See* Theft losses)
Burial or funeral expenses.....22, 116, 155
Business use of home.....95, 156-157

C

Cafeteria plans.....43
Campaign contributions received.....81
Campaign expenses.....158
Cancellation of debt.....77
Cancelling a lease.....61
Capital asset defined.....90
Capital gain distributions.....58, 61, 99
Capital gains and losses.....91-93, 98-99
Car accidents.....129
Car expenses (*See also* Travel and transportation).....138-140
  Charitable contribution.....126
  Medical expense.....117
  Moving expense.....135
Car phone (*See* Employee expenses)
Car pool expenses.....140
Carryover, capital loss.....99
Casualties.....128-133
Certificates of deposit.....54
Change of address.....9, 12
Charitable contributions.....125-128
Checks, year received.....11
Check-writing fees.....158
Child:
  Gifts to.....49
  Tax on investment income of.....163-168
Child care credit.....169-175
Child support.....24, 109
Chiropodists.....116
Chiropractors.....116
Christian Science practitioners.....116
Christmas gifts.....40
Citizens abroad.....7
Claims for refund.....14
Clergy.....45
Clerical help, deductibility of.....157
Closing costs (settlement fees).....85, 95
Commissions, advance.....40
Common law marriage.....15
Community property.....16, 177
Commuting expenses.....138, 158
Compensation (*See particular type*)
Computer (*See* Employee expenses)
Condemnations.....95, 129
Condominiums.....93
Constructive receipt of income.....10, 55
Contributions, charitable.....125-128
Convention expenses.....142, 143
Cooperative apartments.....65, 93, 119
Copyrights.....80, 91
Corporate officers' expenses.....138
Cost-of-living allowances, government.....40
Coupon bonds.....55
Court awards.....77
CPA exam review course.....153
Credits:
  Child and dependent care.....169-175
  Diesel-powered vehicles.....183
  Earned income.....181-183
  For the disabled.....176-180
  For the elderly.....176-180
  Foreign tax.....119, 120, 181
  Minimum tax.....162, 181
  Mortgage interest.....123, 181
  Railroad retirement tax overpaid.....183
  Regulated investment company.....183
  Social security tax overpaid.....183
Custodian fees.....157
Custody:
  Custodial parent.....24
  Noncustodial parent.....24
Customs duties.....120

D

Damages.....77, 118
Day-care center.....157, 170
Death benefits:
  Employees.....82
  Exclusion.....71
  Life insurance.....82
  Public safety officers.....82
Debt instruments (*See* Bonds)
Debts:
  Bad debts.....92
  Cancellation or forgiveness.....77
  Paid by another.....11, 77
Deceased taxpayer (decedent).....7, 18, 25-27, 51, 117
Deductions (*See particular type*)
Dependency tests.....20-22
  Support by divorced or separated parents.....22-24
Dependent care:
  Assistance.....43
  Credit for.....169-175
Dependents.....4
  Exemption.....18-24
  Filing requirements.....4
  Medical expenses.....115
  Social security number.....9, 24
  Standard deduction.....113
Deposits, loss on.....92, 129
Depreciation:
  Car.....139
  Rental property.....64-67
Diaper service.....116
Diesel-powered highway vehicles, credit for.....183
Directors' fees.....78
Disability fund tax.....119
Disability income.....44, 73-74, 82
Disabled, credit for.....176-180
Disaster area losses.....132
Disaster relief.....82
Discount, bonds and notes issued at.....53-54
Distributions from:
  Bond purchase plans.....72
  Corporations.....57-61
  Estates and trusts.....78
  Individual retirement arrangements.....106
  S corporations.....79
Dividends.....57-61
Divorced taxpayers:
  Alimony.....108-111

Dependent, support test.....22
Exemptions.....18
Filing status.....15, 16
Transfers of property.....89
Dog tags.....120
Donations to charity (*See* Contributions, charitable)
Drugs and medicines.....116
Due dates.....11
Dues:
Club.....126
Union.....41, 127, 156

E

Early withdrawal of savings.....57
Earned income:
Child and dependent care credit.....171
Earned income credit.....181-183
Earned income credit table.....216
Easements.....85
Education Savings Bond Program.....52
Educational assistance.....43
Educational assistance program.....43
Educational expenses.....152-155
Elderly (*See* Older taxpayers)
Electronic filing.....8
Employee achievement awards.....81
Employee expenses:
Cellular telephone.....156
Education.....152-155
Home computer.....156, 157
How to report.....144
Miscellaneous.....155-157
Travel and transportation.....138-151
Employment:
Abroad.....46
Agency fees.....156
Interview expenses.....40
Resumé expenses.....156
Employment taxes.....172
Entertainers and musicians.....155
Entertainment expenses.....143
Estate tax.....27, 71, 158
Estates and trusts, income from.....78
Estimated tax.....32-36, 37
Credit for.....36-37
How to figure.....33
Payment-voucher.....36
Penalty.....37-38
When to pay.....34
Examination of return.....208
Exchanges (*See* Sales and exchanges)
Excise taxes.....120
Executors and administrators.....7, 25
Fees received.....78
Exempt income (*See also particular type*).....81-83
Exemptions.....18-24, 27
Phaseout of.....24
Expenses (*See particular type*)
Expenses in respect of decedent.....27
Extensions.....11-12
Eyeglasses.....116

F

Face lift.....116
Fair market value.....78, 86, 88, 127, 130
Fair rental value.....22
Federal Employees Compensation Act payments.....81, 83
Federal unemployment (FUTA) tax.....173
Fees (*See particular type*)
Fellowships and scholarships.....22, 83
FICA (*See* Social security tax)
Filing requirements.....4-7
Filing status.....15-18
Final return.....25-26
Finance charges.....124
Fines.....140, 158
Fiscal year.....10, 34, 36
Fixing-up expenses.....95
Foreign:
Accounts.....10
Conventions.....143
Employer.....45
Students.....20
Tax credit or deduction.....119, 120, 181
Forms (*See also* Returns *and* Schedules):
RRB-1099.....74
SS-5.....9, 25
SSA-1099.....74
W-2.....10, 36
W-2G.....36
W-2P.....36, 106
W-4.....28-31, 173
W-4P.....32, 69
W-4S.....31
W-5.....173, 181
W-9.....49, 57
W-10.....171
940.....173
942.....173
1040.....8, 56, 61, 161-162, 192-197
1040A.....8, 55, 60, 160, 186-189
1040-ES.....32, 35
1040-ES(NR).....33
1040EZ.....7, 160, 184-185
1040X.....14
1065.....79
1096.....56, 61
1098.....68, 123
1099-B.....79, 98
1099-DIV.....36, 57, 59
1099-G.....79
1099-INT.....36, 49, 55
1099-MISC.....57, 77
1099-OID.....53
1099-R.....36, 52, 72, 106
1099-S.....98
1116.....55, 60, 181
1128.....10
1310.....25
2106.....148, 150-151, 154, 155
2119.....97
2120.....22
2210.....37
2439.....58, 183
2441.....172
2688.....11
3903.....137
4070.....47
4070A.....47
4136.....183
4137.....48
4468.....183
4562.....68
4684.....133
4782.....137
4810.....25
4868.....11
4972.....72
5329.....107
6251.....182
8271.....84
8283.....128
8332.....24
8396.....181
8582.....98
8615.....49, 57, 164-168
8801.....181
8814.....49, 57, 164
8815.....52
8818.....52
8822.....12
8824.....89
Foster child.....17, 20
Foster parents and providers.....81, 126
Fringe benefits.....31, 41-43
Funeral or burial expenses.....22, 116, 155
FUTA.....173

G

Gains and losses:
Basis.....85-88
Capital or ordinary.....91-93
Casualty and theft losses.....128-133
Deposits.....92
Estates and trusts.....78
Figuring gain or loss.....88-89
Gambling.....78, 158
Hobby.....78
Home, sale of.....93-98
Passive activity losses.....16, 49, 57, 83
Personal items.....78
Recovered losses.....79
Related parties.....90
Reporting gains and losses.....98-100
Gambling winnings and losses.....32, 78, 158
Garnishments and attachments.....10
General Rule for pensions and annuities.....69
Gifts (*See also* Contributions, charitable):
Basis.....86
Business.....144
Christmas, from employer.....40
Holding period.....93
Not taxed.....81
To reduce the public debt.....13
Grants.....83
Gross income.....4
Ground rent, redeemable.....123
Group life insurance.....42
Group medical insurance premiums.....44, 115
Guide dogs.....116

H

Handicapped people.....117, 158, 169
Head of household.....17
Health insurance.....115-117, 118
Self-employed.....115
Hearing aids.....116
Heirs (*See* Beneficiary of)
Hobbies.....78
Holding period.....92-93
Home:
Business use of.....95, 156-157
Changed to rental property.....82, 87, 95
Closing costs.....85, 95
Cost of keeping up.....17
Damage to.....128
Day care center.....157
Fixing-up expenses.....95
Main home defined.....83, 93
Purchase.....95, 135

Renting.....61
Sale of.....93-98, 135
Settlement fees.....85, 95
Tax home defined.....142
Vacation.....63-68
Home mortgage (*See* Interest)
Houseboat.....93
Household employees.....172
Househunting expenses.....135
Housetrailer.....93
Husband (*See* Spouse)

I

Impairment-related work expenses.....117, 158
Improvements.....62, 85, 94
Imputed interest (*See* Unstated interest)
Income (*See particular type*)
Income in respect of decedent.....26
Income-producing expenses.....157
Indefinite assignment.....142
Individual retirement arrangements (IRAs).....16, 101-108, 157
Contributions.....101-106
Distributions.....106
Penalties.....107
Rollovers.....106
Simplified employee pension (SEP).....108
Inheritances:
Basis.....87
Holding period.....93
Home.....96
Not taxed.....81
Injured spouse.....12
Injury and illness payments.....40, 73-74, 82
Installment buying.....124
Insurance policies exchanged.....90
Insurance premiums:
Alimony payments, part of.....109
Group life.....42
Home.....158
Life.....158
Medical.....44, 115-117
Mortgage.....158
Paid in advance.....50
Paid in installments.....122
Rental.....62
Self-employed.....115
Insurance proceeds:
Accident and health.....83, 118
Dividends.....59
Dividends, interest on.....50
Endowment.....81
Installment payments.....52, 82
Interest on.....52, 82
Life.....52, 72, 82
Medical.....118
Property.....131, 132
Veterans.....46
Interest:
Below-market loans.....124
Expense.....121-125
Expense limit.....27, 122
Frozen deposits.....49, 55, 56, 81
Income.....48-57
Mortgage.....122-124
On unpaid taxes.....12
Personal.....27, 124-125
Reduction.....208
Rule of 78's.....124
Interlocutory decree of divorce.....108
Interview expenses.....40
Investment clubs.....78
Investment income, tax on child's.....163-168
Investment property.....91
IRA (*See also* Individual retirement arrangements (IRAs)).....101-108
Itemizing deductions (*See also particular type*).....113, 161
Changing your mind.....113
Recoveries.....79

J

Job hunting (*See* New job)
Job-related expenses (*See* Employee expenses)
Joint accounts.....49, 56, 58
Joint returns (*See* Returns)
Jury duty.....78

K

Kickbacks.....78

L

Laboratory fees.....116
Late payment charges.....124
Leases cancelled or transferred.....61
Leasing a car.....140
Legal expenses.....158
License and similar fees.....158
Life insurance:
Premiums.....42, 158
Proceeds.....52, 72, 82
Limits:
Capital loss.....99
Casualty and theft loss rules.....131
Charitable contributions.....128
Depreciation.....139
Interest.....122
Meals and entertainment.....135, 143
Medical and dental expenses.....115
Miscellaneous deductions.....155
Moving expenses.....136
Liquidating distributions (dividends).....58
Literary compositions.....91
Loan origination fees.....123
Loan placement fees.....123
Loans (*See* Interest *and* Debts)
Lockout benefits.....41
Long-term gains and losses.....92, 98
Losses (*See* Gains and losses)
Lost property.....129
Lotteries.....78
Lump-sum distributions.....72

M

Main home.....63
Market discount bonds.....54, 57
Married taxpayers (*See also* Spouse):
Estimated tax.....33
Filing status.....15
Signing joint return.....16
Maternity clothes.....116
Meals and lodging.....143
Business travel.....140
For housekeeper.....170
Medical.....117
Support for dependent.....21
Taxability of.....42
Medical expenses.....115, 118, 171
Child of divorced or separated parents.....24
Medical insurance.....115-117, 118
Self-employed.....115
Medicare.....115
Medicines and drugs.....118
Mileage allowance (*See also* Car expenses).....140, 147
Military (*See* Armed forces)
Mineral royalties.....80
Minimum tax credit.....162, 181
Ministers.....45
Miscellaneous deductions.....155-159
Mobile home.....93
Modified accelerated cost recovery system (MACRS).....85
Money market certificates.....50
Mortgage interest credit.....123, 181
Mortgages:
Insurance premiums.....158
Interest on.....122-124
Prepayment penalty.....124
Special rules.....123
Moving expenses.....133-138
Multiple support:
Agreement.....22
Medical expenses.....115
Municipal bonds.....54
Musical compositions.....91
Musicians and entertainers.....155
Mutual funds.....58, 88, 157

N

Net operating loss.....133
New job:
Employment agency fees.....156
Interview expenses.....40
Moving expenses.....133-138
Resumé expenses.....156
Travel expenses.....142, 156
Nominees.....49, 53, 56, 57, 61
Nonaccountable plans.....148
Nonresident aliens.....7, 16, 17
Nontaxable distributions.....58
Nontaxable exchanges (trades).....86, 89-90, 93
Nontaxable items.....81-83
Not-for-profit activities.....77
Notes:
Discounted.....53, 91
Received for services.....78
Nursing home.....117

O

Office rent, deductibility of.....157
Office use of home.....156-157
Older taxpayers:
Credit for the elderly.....176-180
Excluding gain on sale of home.....98
Filing requirements.....4
Original issue discount.....53-54, 57, 91
Outside salesperson.....138
Overpayment of tax:
Credited to estimated tax.....36
Refunded.....12

P

Parent's responsibility for child's tax.....7
Parking fees and tolls:
Contributions.....126
Employee business expenses.....140
Medical.....117

Partners and partnerships.....79, 157
Passive activity losses.....16
Patents.....80
Patronage dividends.....59
Payment of tax.....12
Peace Corps allowances.....46
Penalties:
  Cancellation.....208
  Deductibility.....122, 158
  Early withdrawal of savings.....57
  Estimated tax.....37-38
  Failure to file.....13
  Failure to furnish tax shelter registration number.....14
  Failure to pay.....13
  Failure to supply social security number.....14
  Fraud.....14
  Frivolous return.....13
  Negligence.....49
  Substantial understatement of income tax.....13
  Tax shelters.....84
  Underpayment of tax (*See* Failure to pay *under* Penalties)
Pension contributions.....44
Pensions.....69-74
Per diem allowance.....145, 146, 147
Performing artists.....144, 155
Permanent and total disability.....176
Personal exemption.....18, 27
Personal interest.....27, 124-125
Personal property (*See* Property)
Personal property tax.....120
Phone numbers, toll-free.....220
Points.....123
Political campaign expenses.....158
Prepaid:
  Income.....11
  Insurance.....50, 115
  Interest.....121
  Rent.....61
Preparer's fee.....158
Presidential Election Campaign Fund.....9
Principal residence (*See* Home)
Private schools, tuition to.....127
Prizes and awards.....40, 78
Profit-sharing plans:
  Employer contributions.....44
  Lump-sum distributions.....72
Property:
  Basis of.....85-88
  Casualty and theft loss to.....128-133
  Changed to rental property.....62, 87
  For services.....40, 86
  Gifts to charity.....127
  Inherited.....81, 87
  Real and personal property defined.....130-131
  Received as a gift.....86
  Rental.....61-68
  Sale of (*See also* Sales and exchanges).....88-93
  Taxes on.....85, 119-120
Protective clothing.....156
Psychiatric care.....116
Public assistance benefits.....82
Publications list.....226
Puerto Rico, residents of.....7

R

Raffles.....78
Railroad retirement benefits:
  Repayments.....76
  Tier 1 benefits, taxability.....74-77
Railroad retirement tax:
  Credit for overpayment of tax.....183
  Withholding on tips.....47
Rates of tax.....215
Real estate investment trusts.....58, 93
Real estate mortgage investment conduits (REMICs).....54
Real estate tax.....85, 119
Real property (*See* Property)
Recapture, alimony.....110-111
Recordkeeping:
  Car expenses.....140
  Contributions, charitable.....128
  Employee business expenses.....148
  General requirements.....15
  Home.....94
  Tips.....47, 48
Recoveries of:
  Amounts previously deducted.....79
  Itemized deductions.....79
  Stolen property.....130, 133
Refunds (*See also* Tax refunds).....162
  Of interest.....122
  Of state income tax (recoveries).....79
  Offset against debts.....12, 14
  Past due.....12
  Taxability.....79
Regulated investment company.....183
Reimbursements:
  Casualty and theft loss.....131, 132
  Employee business expenses.....138, 140, 145
  Medical expenses.....118
  Moving expenses.....137
Related parties, transactions between.....90
Rental income and expenses.....61-68
Repayment, amount previously included in income.....80
Reservists' transportation.....139
Residence (*See* Home)
Resident aliens.....7
Retirement of bonds.....91
Retirement pay:
  Armed forces.....46
  Pensions and annuities.....69-74
Retirement plans:
  Elective deferrals.....44
  Federal Thrift Savings Fund.....44
  For employees.....44, 69-74
  Individual retirement arrangements.....101-108
  Voluntary payments to.....72
  401(k) plans.....69
  457 plans.....69
Return of capital.....58-59
Returns:
  Aliens.....7
  Amended.....14
  Child.....4, 164-168
  Deceased taxpayer (decedent).....7, 25-26
  Estimated tax.....35
  Extension of filing date.....11-12
  Filing status.....15-18
  Final.....25
  How to file.....8-11
  Joint.....16, 18
  Puerto Rican residents.....7
  Separate.....16, 18, 137
  Signatures.....10, 16, 25
  When to file.....11-12
  Where to file (*See Back cover*)
  Which form to use.....7-8
  Who must file.....4-7
Robbery (*See* Theft losses)
Rollovers.....72, 106
Rounding off dollars.....9
Royalties.....80-81
Rule of 78's.....124

S

S corporations.....79, 157
Safe deposit box.....158
Salaries, wages, etc.....39-46
Sales and exchanges:
  Bonds.....52, 91
  General rules.....88-93
  Home.....93-98
Sales tax.....119, 120
Salespersons.....138
Savings bonds.....50-52, 55
Savings certificate.....50, 54
Schedules (Form 1040):
  A.....194, 198
  B.....61, 192, 199
  C.....68
  D.....98-100, 192, 200-201
  E.....68, 193, 202-203
  K-1.....49, 57, 157
  R.....178
  SE.....7, 195, 204, 205
Schedule 1 (Form 1040A):
  Part I.....55, 190
  Part II.....60, 190
Schedule 2 (Form 1040A).....172, 191
Schedule 3 (Form 1040A).....178
Scholarships.....22, 83
Security deposit.....61, 137
Self-employed persons.....7, 162
  Health insurance premiums.....115
Self-employment tax.....27
  Deduction for.....120
Separate maintenance decree.....108
Separate returns (*See* Returns)
Separated taxpayers:
  Dependent, support test.....22
  Filing status.....15
Separation agreement, alimony.....108
Service Center addresses (*See Back cover*)
Service charges.....122, 157
Settlement fees.....85, 95
Severance pay.....40
Shareholder, S corporation.....79
Short sale of stock.....60
Short-term gains and losses.....92, 98
Sick pay.....31, 40, 82
Signing your return.....10, 16, 25
Simplified employee pension (SEP).....108
Social security benefits:
  Medicare.....118
  Repayments.....76, 158
  Taxability.....74-77
Social security number.....9, 24, 58
Social security tax:
  Credit for overpayment.....183
  Deductibility.....120
  For household employee.....120, 121, 173
  Withholding on tips.....47-48
Spouse (*See also* Married taxpayers):
  Deceased.....7, 18, 25
  Disabled, qualifying person for credit.....170
  Exemption for.....18
  IRA for.....101, 102

Medical expenses for.....115
Standard deduction.....113
Surviving.....18, 26
Travel expenses for.....143
Standard deduction.....27, 112-114, 161
Age 65 or older.....113
Blindness.....113
Dependents.....113
Persons not eligible.....112
Spouse.....113
Table.....114
Standard meal allowance.....141
Standard mileage rate.....140, 147
State:
Benefit payments (*See also* AFDC payments *and* Welfare benefits).....21
Income tax.....119
Income tax refunds (recoveries).....79
Obligations, interest on.....54
Statute of limitations (*See also* Claims for refund).....96
Sterilization.....116
Stock:
Appreciation rights.....40
Basis.....87-88
Dividends.....59
For services.....40
Holding period.....92
Indirect ownership.....90
Mutual fund.....88, 93
Options.....40
Rights.....59, 93
Sale or exchange.....89
Short sales.....60
Small business.....92
Worthless.....91
Stock bonus plans:
Employer contributions.....44
Lump-sum distributions.....72
Stockholders' meeting expenses.....159
Strike benefits.....41
Students:
Dependent.....21
Fellowships, grants, and scholarships.....22, 83
Living in your home.....126
Loan cancelled.....77
Theological.....45
Withholding, exemption from.....29
Support, decree of.....108
Support for dependent.....21-24
Survivor annuities.....71
Survivors.....26, 135

T

Tables:
Earned income credit.....216
Tax.....209
Tax rate schedules.....161, 215
Tax (*See also* Taxes):
On child's investment income.....163-168
On early pension distributions.....72
On excess pension distributions.....73
Tax counsel fees.....158
Tax-exempt:
Bonds and other obligations.....54, 91, 122
Income.....81-83, 159
Interest.....54, 55, 56
Tax figured by IRS.....162-163
Tax-free exchanges (*See* Nontaxable exchanges)
Tax home.....142
Tax penalties (*See* Penalties)
Tax preference items.....162
Tax refunds:
Claim for.....14
Deceased taxpayers (decedents).....25
General rules for.....12
Interest on.....12, 50
Less than $1.....12
Offset against debts.....12
Past due.....12
State income tax recoveries.....79
Tax shelters.....83-84
Tax table.....209
Taxable income.....160, 161
Taxes (*See also particular type*).....118-121
Alternative minimum.....162
Business.....120
Credit for.....36
Deductible.....118
Employment.....120, 121
Estimated.....32, 37
Foreign.....119, 181
How to figure.....160-163
Income.....119
IRA penalties.....107
Minor children.....163-168
Not deductible.....120
Personal property.....120
Railroad retirement.....183
Real estate.....119
Sales.....119, 120
Self-employment.....27, 162
Social security.....40, 183
Withholding.....27-32, 36
Taxi fares.....140
Teachers' educational expenses.....153
Telephones.....159
Temporary assignment.....142
Temporary living expenses.....135
Tenants by the entirety.....49, 58
Tenants in common.....49, 58
Theft losses.....128, 129-133
Three-Year Rule for pensions and annuities.....69
Tips.....47-48
Toll-free numbers.....220
Tools.....138
Tour, free.....78
Trade-in.....86, 89
Trading date.....92
Transient workers.....142
Transfer tax.....120
Transporting schoolchildren.....82
Travel and transportation:
Contributions.....126
Educational.....141, 154
Employees.....138-151
Free tour.....78
In the United States.....142
Investment-related.....142
Medical.....117
Moving.....135
New employment.....156
Outside the United States.....143
Treasury notes.....50, 90
Trusts.....78
Tuition, parochial school.....127

U

Underpayment of estimated tax, penalty for.....37-38
Unemployment compensation.....40
Uniform Gifts to Minors Act (*See* Gifts to *under* Child)
Uniforms.....126, 156
Union:
Assessments.....41, 156
Benefits.....41
Dues.....41, 127, 156
Unstated interest.....85, 124
U.S. citizens abroad.....7
U.S. obligations, interest.....50
Use of home in business.....156-157
Usurious interest.....50

V

Vacation homes.....63-68
Vandalism.....129
Veterans' benefits.....22, 46
VISTA volunteers.....46

W

Wages, salaries, etc.....39-46
Welfare benefits (*See also* Benefit payments *under* State).....82
Wheelchair.....116
When to file.....11-12
Where to file (*See also Back cover*).....14
Deceased taxpayer (decedent).....25
Who should itemize.....113
Widows and widowers.....18
Wife (*See* Spouse)
Withholding:
Backup.....32, 79
Credit for.....36
Fringe benefits.....31
Gambling winnings.....32
General rules.....27-32
Household employer.....172
Pensions and annuities.....31-32, 69
Salaries and wages.....28-31
Sick pay.....31
Tips.....31, 47-48
Work clothes.....156
Work expenses, impairment-related.....158
Workers' compensation.....82
Worthless securities.....91

Tax Publications

You can use the order blank in this publication to send for any other IRS tax publications you need. Many of these free publications are listed below. A full list can be found in Publication 910.

You can also use the order blank to send for any tax forms, schedules, or instructions you need.

General Guides

1 ..... Your Rights as a Taxpayer
225 ..... Farmer's Tax Guide
334 ..... Tax Guide for Small Business
509 ..... Tax Calendars for 1991
553 ..... Highlights of 1990 Tax Changes
595 ..... Tax Guide for Commercial Fishermen
910 ..... Guide to Free Tax Services

Specialized Publications

3 ..... Tax Information for Military Personnel
4 ..... Student's Guide to Federal Income Tax
15 ..... Employer's Tax Guide (Circular E)
54 ..... Tax Guide for U.S. Citizens and Resident Aliens Abroad
378 ..... Fuel Tax Credits and Refunds
448 ..... Federal Estate and Gift Taxes
463 ..... Travel, Entertainment, and Gift Expenses
501 ..... Exemptions, Standard Deduction, and Filing Information
502 ..... Medical and Dental Expenses
503 ..... Child and Dependent Care Expenses
504 ..... Tax Information for Divorced or Separated Individuals
505 ..... Tax Withholding and Estimated Tax
508 ..... Educational Expen[illegible]
510 ..... Excise Taxes for 19[illegible]
513 ..... Tax Information for Visitors to the United States
514 ..... Foreign Tax Credit for Individuals
516 ..... Tax Information for U.S. Government Civilian Employees Stationed Abroad
517 ..... Social Security for Members of the Clergy and Religious Workers
519 ..... U.S. Tax Guide for Aliens
520 ..... Scholarships and Fellowships
521 ..... Moving Expenses
523 ..... Tax Information on Selling Your Home
524 ..... Credit for the Elderly or the Disabled
525 ..... Taxable and Nontaxable Income
526 ..... Charitable Contributions
527 ..... Residential Rental Property
529 ..... Miscellaneous Deductions
530 ..... Tax Information for Homeowners
531 ..... Reporting Income From Tips
533 ..... Self-Employment Tax
534 ..... Depreciation
535 ..... Business Expenses
536 ..... Net Operating Losses
537 ..... Installment Sales
538 ..... Accounting Periods and Methods
541 ..... Tax Information on Partnerships
542 ..... Tax Information on Corporations
544 ..... Sales and Other Dispositions of Assets
545 ..... Interest Expense
547 ..... Nonbusiness Disasters, Casualties, and Thefts
550 ..... Investment Income and Expenses
551 ..... Basis of Assets
552 ..... Recordkeeping for Individuals
554 ..... Tax Information for Older Americans
555 ..... Federal Tax Information on Community Property
556 ..... Examination of Returns, Appeal Rights, and Claims for Refund
557 ..... Tax-Exempt Status for Your Organization
559 ..... Tax Information for Survivors, Executors, and Administrators
560 ..... Retirement Plans for the Self-Employed
561 ..... Determining the Value of Donated Property
564 ..... Mutual Fund Distributions
570 ..... Tax Guide for Individuals with Income from U.S. Possessions
571 ..... Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
575 ..... Pension and Annuity Income (Including Simplified General Rule)
583 ..... Taxpayers Starting a Business
584 ..... Nonbusiness Disaster, Casualty, and Theft Loss Workbook
586A ..... The Collection Process (Income Tax Accounts)
587 ..... Business Use of Your Home
589 ..... Tax Information on S Corporations
590 ..... Individual Retirement Arrangements (IRAs)
593 ..... Tax Highlights for U.S. Citizens and Residents Going Abroad
596 ..... Earned Income Credit
597 ..... Information on the United States–Canada Income Tax Treaty
721 ..... Tax Guide to U.S. Civil Service Retirement Benefits
907 ..... Tax Information for Persons with Handicaps or Disabilities
908 ..... Bankruptcy and Other Debt Cancellation
909 ..... Alternative Minimum Tax for Individuals
911 ..... Tax Information for Direct Sellers
915 ..... Social Security Benefits and Equivalent Railroad Retirement Benefits
917 ..... Business Use of a Car
919 ..... Is My Withholding Correct for 1991?
924 ..... Reporting of Real Estate Transactions to IRS
925 ..... Passive Activity and At-Risk Rules
926 ..... Employment Taxes for Household Employers
929 ..... Tax Rules for Children and Dependents
936 ..... Limits on Home Mortgage Interest Deduction
937 ..... Business Reporting
939 ..... Pension General Rule (Nonsimplified Method)
1167 ..... Substitute Printed, Computer-Prepared and Computer-Generated Tax Forms and Schedules
1212 ..... List of Original Issue Discount Instruments
1244 ..... Employee's Daily Record of Tips (Form 4070–A) and Employee's Report of Tips to Employer (Form 4070)
1542 ..... Per Diem Rates
1544 ..... Reporting Cash Payments of Over $10,000

Spanish Language Publications

1S ..... Derechos del Contribuyente
179 ..... Guía Contributiva Federal Para Patronos Puertorriqueños (Circular PR)
556S ..... Revisión de las Declaraciones de Impuesto, Derecho de Apelación y Reclamaciones de Reembolsos
579S ..... Cómo Preparar la Declaración de Impuesto Federal
586S ..... Proceso de Cobro (Deudas del Impuesto Sobre Ingreso)
850 ..... English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service

How to Get IRS Forms and Publications

You can order tax forms and publications from the IRS Forms Distribution Center for your state at the address below. Or, if you prefer, you can photocopy tax forms from reproducible copies kept at many participating public libraries. In addition, many of these libraries have reference sets of IRS publications which you can read or copy.

If you are located in:	Send to "Forms Distribution Center" for your state
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming	Rancho Cordova, Ca. 95743-0001
Alabama, Arkansas, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Texas, Wisconsin	P.O. Box 9903, Bloomington, IL 61799
Connecticut, Delaware, District of Columbia, Florida, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia	P.O. Box 25866, Richmond, VA 23289

Foreign Addresses—Taxpayers with mailing addresses in foreign countries should send their requests for forms and publications to: Forms Distribution Center, P.O. Box 25866, Richmond, VA 23289; Forms Distribution Center, Rancho Cordova, Ca. 95743-0001, whichever is closer.

Puerto Rico—Forms Distribution Center, P.O. Box 25866, Richmond, VA 23289

Virgin Islands—V.I. Bureau of Internal Revenue, Lockharts Garden, No. 1A, Charlotte Amalie, St. Thomas, VI 00802

Detach at This Line

Order blank—We will send you 2 copies of each form and 1 copy of each set of instructions or publication you circle. Please cut the order blank on the dotted line above and **be sure to print or type your name and address accurately on the bottom portion.** This will be the label used to return material to you. Enclose this order blank in your own envelope and address your envelope to the IRS address shown above for your state. To help reduce waste, please order only the forms, instructions, and publications you think you will need to prepare your return. Use the blank spaces to order items not listed. If you need more space, attach a separate sheet of paper listing the additional forms and publications you may need. Be sure to allow 2 weeks to receive your order.

1040	1040EZ	Schedule R (1040) & Instructions	2441 & Instructions	8582 & Instructions	Pub. 508	Pub. 553	
Instructions for 1040 & Schedules	Instructions for 1040EZ	Schedule SE (1040)	3468 & Instructions	8822	Pub. 521	Pub. 590	
1040A	Schedules A&B (1040)	1040-ES (1991)	3903 & Instructions	Pub. 1	Pub. 523	Pub. 910	
Instructions for 1040A, Sch. 1&2	Schedule C (1040)	1040X & Instructions	4562 & Instructions	Pub. 17	Pub. 525	Pub. 917	
Schedule 1 (1040A)	Schedule D (1040)	2106 & Instructions	4868	Pub. 334	Pub. 527	Pub. 929	
Schedule 2 (1040A)	Schedule E (1040)	2119 & Instructions	8283 & Instructions	Pub. 463	Pub. 529		
Schedule 3 (1040A) & Instructions	Schedule F (1040)	2210 & Instructions	8332	Pub. 505	Pub. 545		

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From the Executive Office of the President

Office of Management and Budget

Introduction

Each January the President is required to submit to the Congress his budget proposal for the upcoming fiscal year. The budget sets forth the President's proposed financial plan of operation for the federal government. The plan includes recommendations for new legislative proposals as well as recommendations to change or maintain existing activities.

The Congress can change, eliminate, and add programs to the President's budget. The Congress enacts many separate spending and revenue bills. In addition, the Congress enacts resolutions setting ceilings or targets for total spending and a floor for total receipts.

Fiscal Year 1990 Budget

Data for fiscal year 1990 (which began on October 1, 1989, and ended on September 30, 1990), show that federal outlays were $1,251.9 billion, and receipts were $1,031.5 billion, leaving a deficit of $220.4 billion.

The budget deficit is financed largely by government borrowing from the public. The government borrows from the public by selling bonds and other debt securities to private citizens, banks, other businesses, and governments.

Your Government Dollar

Income and social insurance taxes are, by far, the largest sources of federal receipts. In 1990, individuals paid $466.9 billion in income taxes and corporations paid $93.5 billion in corporation income taxes. Social security and other insurance and retirement taxes and contributions were $380.0 billion. Excise taxes accounted for $35.3 billion of receipts, and the remaining $55.7 billion was accounted for by Federal Reserve deposits, custom duties, estate and gift taxes, and other miscellaneous receipts.

Government receipts provide a wide range of public services. The following is a breakdown of how the federal dollar was spent in 1990.

National defense: $299.3 billion. The federal government spent about 24 cents of each dollar to equip and modernize our armed forces, pay salaries of military personnel, and to pay for defense-related atomic energy activities.

International affairs: $13.8 billion. Over 1 cent of each federal dollar was spent to provide economic, military, and technical assistance to other nations, to fund the administration of foreign affairs and international organizations, and to maintain foreign exchange and information programs abroad.

General science and space: $14.4 billion. Over 1 cent of each dollar was spent to expand scientific knowledge through general science and basic research, including space exploration, and to develop worthwhile uses of space technology.

Energy: $2.5 billion. Less than 1 cent of every dollar was spent to support the development of domestic energy supplies, to promote energy research and information programs, to ensure emergency energy preparedness, and to improve energy conservation.

Natural resources and environment: $17.0 billion. Programs to control pollution, develop water resources, and to maintain and conserve public lands and recreation areas claimed over 1 cent of each federal dollar.

Agriculture: $12.0 billion. About 1 cent of every dollar was spent to stabilize farm income, encourage agricultural research and products, and to prevent the introduction and spread of plant and animal pests and diseases.

Commerce and housing credit: $67.5 billion. About 5 cents of each federal dollar was spent to provide thrift insurance and assistance to small business, to ensure an adequate supply of mortgage credit, and to provide the federal payment to the Postal Service.

Transportation: $29.5 billion. The federal government provides grants to state and local governments for highways, mass transit, and airports. In addition, the federal government maintains the Coast Guard, regulates federal airways, and provides financial assistance to railroads and shipping. These programs claimed over 2 cents of each dollar in 1990.

Community and regional development: $8.5 billion. The federal government provides grants and loans to develop urban and rural areas and to provide relief and insurance to victims of natural disasters. These programs claimed less than 1 cent of each dollar in 1990.

Education, training, employment, and social services: $37.5 billion. In 1990, about 3 cents of each dollar went for grants to elementary, secondary, and vocational education and aid to college students; grants to states for social services; training and employment services; and research and general educational aids.

Health: $58.1 billion. The federal government spent nearly 5 cents of every federal dollar on health programs, not including Medicare and veterans' health programs. Programs in the health category comprise Medicaid, training and research, and consumer and worker safety.

Medicare: $97.7 billion. Nearly 8 cents of each federal dollar was spent for the Medicare program, primarily for the benefit of the aged.

Income security: $148.3 billion. Programs in this category include retirement and disability benefits (other than social security), unemployment compensation, and other programs such as food stamps, cash benefits, and housing assistance. These programs claimed nearly 12 cents of every federal dollar.

Social security: $248.6 billion. In 1990, social security claimed nearly 20 cents of each budget dollar. Outlays for social security go to the old-age and survivors insurance (OASI) and the disability insurance (DI) programs.

Veterans' benefits and services: $29.1 billion. Veterans' programs provide income to veterans and their families, medical services, housing, education and training, and life insurance programs. Outlays for veterans' programs claimed over 2 cents of each dollar in 1990.

Administration of justice: $10.1 billion. Enforcing federal laws, litigating and judicial activities, providing detention and correctional facilities for people charged with or convicted of violating federal laws, and providing financial support for state and local government criminal justice systems claimed nearly 1 cent of every federal dollar spent in 1990.

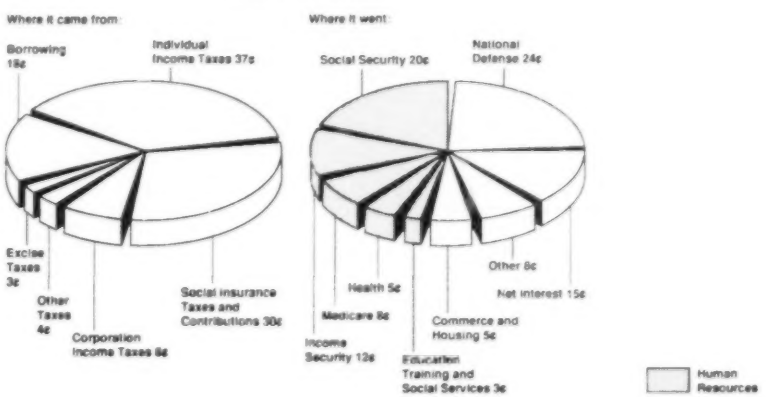
General government: $10.8 billion. Managing government finances and internal government services, financial aid to state and local governments and activities of the executive and legislative branches claimed nearly 1 cent of each dollar.

Net interest: $183.8 billion. Interest payments on the public debt less the portion paid to trust funds and other interest received, took nearly 15 cents of each dollar.

Undistributed offsetting receipts: ($36.6) billion. These offsetting collections are primarily for the employer share of employee retirement, and rents and royalties on the Outer Continental Shelf.

Note. Detail may not add to totals due to rounding.

Fiscal Year 1990
The Government Dollar



Where to File

If an addressed envelope came with your return, please use it. If you do not have one, or if you moved during the year, mail your return to the **Internal Revenue Service Center** for the place where you live. No street address is needed.

If you live in:	Use this address:
Florida, Georgia, South Carolina	Atlanta, GA 39901
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501
American Samoa	Philadelphia, PA 19255
Guam	Commissioner of Revenue and Taxation 855 West Marine Dr. Agana, GU 96910
Puerto Rico *(or if excluding income under section 933)*	Philadelphia, PA 19255
Virgin Islands: Nonpermanent residents	Philadelphia, PA 19255
Virgin Islands: Permanent residents	V.I. Bureau of Internal Revenue Lockharts Garden No. 1A Charlotte Amalie, St. Thomas, VI 00802
Foreign country: *U.S. citizens and those filing Form 2555 or Form 4563*	Philadelphia, PA 19255
All A.P.O. and F.P.O. *addresses*	Philadelphia, PA 19255

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